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In the Supreme Court of the United States

UNITED STATES DEPARTMENT OF THE INTERIOR, ET AL., PETITIONERS

v.

KERR-MCGEE OIL AND GAS CORP.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

ELENA KAGAN
Solicitor General
Counsel of Record
JOHN C. CRUDEN
Acting Assistant Attorney General
EDWIN S. KNEEDLER
Deputy Solicitor General
CURTIS E. GANNON
Assistant to the Solicitor General
MICHAEL T. GRAY
Attorney
Department of Justice
Washington, D.C. 20530-0001
(202) 514-2217

QUESTION PRESENTED

Under Section 303 of the Outer Continental Shelf Deep Water Royalty Relief Act (Royalty Relief Act), 43 U.S.C. 1337(a)(1)(H), the Secretary of the Interior is authorized to suspend royalty payments to the United States on certain oil and gas leases. Such suspensions are to be set on the basis of "a period, volume, or value of production determined by the Secretary," but they "may vary" (such that royalty payments are reinstated) if the price of oil or gas exceeds a certain threshold. Section 304 of the Royalty Relief Act (43 U.S.C. 1337 note entitled "Lease Sales") governs certain leases issued between 1996 and 2000, and it requires the use of Section 303's bidding system "except that" it specifies certain volumes at which "suspension of royalties shall be set." The question presented is:

Whether Section 304 of the Royalty Relief Act authorizes the Secretary of the Interior to vary the suspension of royalties, so as to collect royalties on oil or gas produced when the price of oil or gas exceeds thresholds specified in the lease, notwithstanding statutorily designated suspension volumes.

PARTIES TO THE PROCEEDING

In addition to the parties identified in the caption, Ned Farquhar, Acting Assistant Secretary for Land and Minerals Management, United States Department of the Interior, is the successor in office to C. Stephen Allred, who was, in his official capacity, an appellant in the court of appeals.

TABLE OF CONTENTS

Page

Opinions below 1
Jurisdiction 1
Statutory provisions involved 2
Statement 2
Reasons for granting the petition 10
A. The court of appeals incorrectly interpreted the Royalty Relief Act and failed to give appropriate deference to the Department's reasonable interpretation 11
B. There will be no meaningful opportunity for further interpretation of the Royalty Relief Act in the courts of appeals 18
C. If allowed to stand, the court of appeals' decision will cost the United States Treasury billions of dollars in lost revenue 21
Conclusion 24
Appendix A – Court of appeals opinion (Jan. 12, 2009) ... 1a
Appendix B – District court opinion (Oct. 30, 2007) 12a
Appendix C – Dep't of Interior order (Jan. 6, 2006) 23a
Appendix D – Court of appeals order (Apr. 14, 2009) 41a
Appendix E – Statutory provisions 43a

TABLE OF AUTHORITIES

Cases:

Chevron U.S.A. Inc. v. *NRDC*, 467 U.S. 837 (1984) 11
Commissioner v. *Clark*, 489 U.S. 726 (1989) 13
Dolan v. *USPS*, 546 U.S. 481 (2006) 14
EPA v. *National Crushed Stone Ass'n*, 449 U.S. 64 (1980) 16

Cases—Continued: Page

Fidelity Fed. Bank & Trust v. *Kehoe*, 547 U.S. 1051 (2006) 21, 23
INS v. *Aguirre-Aguirre*, 526 U.S. 415 (1999) 11
National Cable & Telecomms. Ass'n v. *Brand X Internet Servs.*, 545 U.S. 967 (2005) 19
Santa Fe Snyder Corp. v. *Norton*, 385 F.3d 884 (5th Cir. 2004) 8, 9, 19

Statutes and regulations:

Administrative Procedure Act, 5 U.S.C. 706(2) 19
Outer Continental Shelf Deep Water Royalty Relief Act, Pub. L. No. 104-58, 109 Stat. 563 2
§ 302, 109 Stat. 563-565 ..... *passim*
§ 303, 109 Stat. 565 ..... *passim*
§ 304, 109 Stat. 565-566 ..... *passim*, 63a
§ 305, 109 Stat. 566 ..... 11, 63a
Outer Continental Shelf Lands Act, 43 U.S.C. 1331 *et seq.* 2
43 U.S.C. 1334(a) 2, 11, 43a
43 U.S.C. 1337(a)(1) 2, 47a
43 U.S.C. 1337(a)(1)(A)-(G) 4, 47a-48a
43 U.S.C. 1337(a)(1)(H) ..... *passim*, 48a
43 U.S.C. 1337(a)(3)(B) 4, 49a
43 U.S.C. 1337(a)(3)(C) 3, 14, 50a
43 U.S.C. 1337(a)(3)(C)(ii) 3, 6, 15, 50a
43 U.S.C. 1337(a)(3)(C)(v) 4, 15, 17, 52a
43 U.S.C. 1337(a)(3)(C)(v)-(vii) 7, 52a-53a
43 U.S.C. 1337(a)(3)(C)(vi) 4, 15, 17, 53a

Statutes and regulations–Continued: Page

43 U.S.C. 1337(b)(3) 2, 59a
43 U.S.C. 1337(m) 2, 3
43 U.S.C. 1337 note 3, 5, 6, 12
43 U.S.C. 1338 23
43 U.S.C. 1349(b)(1) 19
43 U.S.C. 1344(a)(4) 2, 18, 62a
28 U.S.C. 1295(a)(3) 19
28 U.S.C. 1392(c)(1) 19
30 C.F.R.:
Section 260.110(a)(7) (1996) 12
Section 260.110(g) 5

Miscellaneous:

141 Cong. Rec. 13,002 (1995) 6
61 Fed. Reg. (1996):
p. 3801 12
p. 3804 12
p. 42,715 7
62 Fed. Reg. 39,865-39,866 (1997) 7
65 Fed. Reg. 45,103 (2000) 7
Eugene Gressman et al., *Supreme Court Practice* (9th ed. 2007) 21
Letter from Richard T. Cardinale, Chief of Staff, Land & Minerals Mgmt., U.S. Dep't of the Interior, to Hon. Dianne Feinstein, Chairman, Subcomm. on Interior, Env't & Related Agencies, Senate Appropriations Comm. (Mar. 9, 2009) 22

Miscellaneous—Continued: Page

Minerals Management Service, Department of the Interior, *Deepwater Royalty Relief for New Leases*, 61 Fed. Reg. 12,023 (1996) 6

Office of the Inspector Gen., U.S. Dep't of the Interior, *Investigative Report On the Lack of Price Thresholds in Gulf of Mexico Oil and Gas Leases* (2007) <http://www.doioig.gov/upload/MMS%20ROI&20REDACTED.pdf> 6

U.S. Gov't Accountability Office, *GAO-08-792R, Oil and Gas Royalties: Litigation over Royalty Relief Cost the Federal Government Billions of Dollars* (June 5, 2008) <http://www.gao.gov/new.items/d08792r.pdf> 23

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PETITION FOR A WRIT OF CERTIORARI

The Solicitor General, on behalf of the United States Department of the Interior and its Acting Assistant Secretary for Land and Minerals Management, respectfully petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Fifth Circuit in this case.

OPINIONS BELOW

The opinion of the court of appeals (App., *infra*, 1a-11a) is reported at 554 F.3d 1082. The opinion of the district court (App., *infra*, 12a-22a) is unreported.

JURISDICTION

The judgment of the court of appeals was entered on January 12, 2009. A petition for rehearing was denied

on April 14, 2009 (App., *infra*, 41a-42a). The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATUTORY PROVISIONS INVOLVED

The pertinent statutory provisions are reprinted in an appendix to this petition. App., *infra*, 43a-63a.

STATEMENT

1. a. The Outer Continental Shelf Lands Act (OCSLA), 43 U.S.C. 1331 *et seq.*, grants the Secretary of the Interior (Secretary) the authority to issue and administer leases on the outer Continental Shelf to companies seeking to produce oil and gas from the seabed. The Secretary is charged with administering OCSLA's leasing provisions and also with "prescib[ing] such rules and regulations as may be necessary to carry out" the statute. 43 U.S.C. 1334(a). Oil and gas leases on the outer Continental Shelf are generally issued on the basis of competitive bidding, with leases issued to the highest bidder. 43 U.S.C. 1337(a)(1). Under the terms of OCSLA and the leases, a lessee typically obtains the right to produce and sell oil and gas in exchange for agreeing to pay royalties to the United States at a specified percentage of the amount or value of production saved, removed, or sold from the lease. *Ibid.*; 43 U.S.C. 1337(b)(3). The statute requires leasing activities "to assure receipt of fair market value for the lands leased and the rights conveyed by the Federal Government." 43 U.S.C. 1344(a)(4).

b. On November 28, 1995, Congress amended OCSLA by enacting the Outer Continental Shelf Deep Water Royalty Relief Act (Royalty Relief Act or RRA), Pub. L. No. 104-58, 109 Stat. 563. The Royalty Relief Act allows the Secretary, under certain conditions, to suspend the payment of royalties to the United States

by oil and gas lessees. As relevant here, the statute addresses royalty relief for three different circumstances: (1) for new production of oil and gas under pre-existing leases for deepwater tracts in certain specified parts of the Gulf of Mexico, RRA § 302, 109 Stat. 563-565 (43 U.S.C. 1337(a)(3)(C)); (2) for production of oil and gas under new leases for OCSLA lands generally, § 303, 109 Stat. 565 (43 U.S.C. 1337(a)(1)(H)); and (3) for production of oil and gas under new leases issued during the five-year period immediately following the enactment of the Royalty Relief Act for deepwater tracts in the same parts of the Gulf of Mexico noted above, § 304, 109 Stat. 565-566 (43 U.S.C. 1337 note entitled "Lease Sales").

With regard to the first category of royalty relief—for newly produced oil and gas under pre-existing leases on deepwater tracts in specified parts of the Gulf of Mexico—Congress provided that, if the Secretary found that new production under a lease would not be economically viable without relief from royalties, the Secretary could then "determine the volume of production from the lease or unit on which no royalties would be due in order to make such new production economically viable; except that for new production * * *, in no case will that volume be less than" one of three specified amounts (depending on the depth of the relevant tract). 43 U.S.C. 1337(a)(3)(C)(ii). Notwithstanding those minimum production volumes (beneath which royalties would generally not be due), Congress further provided that, even "[d]uring the production" of those minimum volumes, such oil and gas would remain "subject to royalties at the lease stipulated royalty rate" in any year during which the "arithmetic average of the closing prices on the New York Mercantile Exchange" for oil or gas exceeded certain specified price thresholds—$28.00

per barrel of oil and $3.50 per million British thermal units for natural gas, adjusted for inflation. 43 U.S.C. 1337(a)(3)(C)(v) and (vi). Thus, Congress established a system for pre-existing deepwater leases that made royalty relief generally available when new production remained below certain volumes, but that still required royalties to be paid on production below those volumes in years when the price of oil or gas exceeded certain thresholds.[1]

With regard to the second category of royalty relief—for oil and gas produced under new OCSLA leases generally—Section 303 of the Royalty Relief Act established that the Secretary could opt to use a new form of bidding system for such leases, as an alternative to one of the seven others already available under OCSLA.[2] Under that new system, bidding would be based on a

> cash bonus bid with royalty at no less than 12 and ½ per centum fixed by the Secretary in amount or value of production saved, removed, or sold, and with suspension of royalties for a period, volume, or value of production determined by the Secretary, which suspensions may vary based on the price of production from the lease.

43 U.S.C. 1337(a)(1)(H). Thus, under that system, even though royalties may be suspended under a new lease

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[1] Section 302 also authorized (but did not require) the Secretary to reduce or eliminate the royalty or net profit share specified in leases in roughly the same specified parts of the Gulf of Mexico in order to promote development of increased production or to encourage production of marginal resources. See 43 U.S.C. 1337(a)(3)(B). That separate authorization is not at issue here.

[2] See 43 U.S.C. 1337(a)(1)(A)-(G) (enumerating the other available bidding systems).

"for a period, volume, or value of production," the Secretary may further provide that the suspension, once prescribed, would then "vary based on" price thresholds determined by the Secretary. The Department of the Interior (Department) has codified in regulations its authority to "vary" royalty suspensions for such leases "based on the price of production." 30 C.F.R. 260.110(g).

This case involves the third category of royalty relief—for new oil and gas leases on deepwater tracts in the same specified parts of the Gulf of Mexico that were issued in the five years after November 28, 1995. In Section 304 of the Royalty Relief Act, Congress required those leases to be sold on the basis of the new bidding system it had created in Section 303. RRA § 304, 109 Stat. 565-566 (43 U.S.C. 1337 note entitled "Lease Sales"). More specifically, Section 304 provides as follows:

> For all tracts located in water depths of 200 meters or greater in [specified parts of the Gulf of Mexico], any lease sale within five years of the date of enactment of this title [November 28, 1995], shall use the bidding system authorized in section 8(a)(1)(H) of the Outer Continental Shelf Lands Act, as amended by this title [43 U.S.C. 1337(a)(1)(H)], except that suspension of royalties shall be set at a volume of not less than the following:
>
> (1) 17.5 million barrels of oil equivalent for leases in water depths of 200 to 400 meters;
>
> (2) 52.5 million barrels of oil equivalent for leases in 400 to 800 meters of water; and
>
> (3) 87.5 million barrels of oil equivalent for leases in water depths greater than 800 meters.

RRA § 304, 109 Stat. 565-566 (43 U.S.C. 1337 note entitled "Lease Sales").[3] Although Section 304 addresses the minimum volume at which royalty suspensions are to be "set," it is silent with respect to Section 303's further authorization for the Secretary to "vary" a suspension if the price of oil or gas exceeds certain price thresholds.

In light of Section 304's incorporation of Section 303, the Department determined that the royalty suspensions in new leases issued under Section 304 in the five years after November 28, 1995 could "vary" as provided in Section 303 and therefore would be subject to price thresholds. New leases issued in 1996, 1997, and 2000 included such price thresholds. App., *infra*, 25a.[4]

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[3] The minimum volumes specified in Section 304—which were the same as the ones established by Section 302 for new production under pre-existing leases, 43 U.S.C. 1337(a)(3)(C)(ii)—originated with the Department and "were developed out of technical analyses conducted by [the Minerals Management Service (MMS)] of the royalty suspension volumes needed for capital cost recovery in developing unproduced oil and gas fields at various water depths in the Gulf of Mexico." Minerals Management Service, Department of the Interior, *Deepwater Royalty Relief for New Leases*, 61 Fed. Reg. 12,023 (1996); see 141 Cong. Rec. 13,002 (1995).

[4] The Department did not include price thresholds in leases that were issued in 1998 and 1999, even though they too were governed by Section 304. When that omission came to light, it triggered congressional concerns and an investigation by the Department's Inspector General. See Office of the Inspector Gen., U.S. Dep't of the Interior, *Investigative Report On the Lack of Price Thresholds in Gulf of Mexico Oil and Gas Leases* 5 (2007) <http://www.doioig.gov/upload/MMS%20ROI%20REDACTED.pdf>. The Inspector General's final report concluded that the omission had been inadvertent and inconsistent with the "policy decision" that the Department made "shortly after the inception of the Outer Continental Shelf Deep Water Royalty Relief Act in 1995 * * * to include price thresholds in the leases issued between 1995 and 2000." *Id.* at 2; see *ibid.* ("MMS field personnel initially attached ad-

2. This case involves eight leases issued in 1996, 1997, or 2000 pursuant to Section 304 of the Royalty Relief Act, under which respondent is a lessee or operator. App., *infra*, 24a, 36a-37a. The notices for each of the three sales at which the leases were purchased—which were published in the *Federal Register*—provided that the leases would include royalty suspensions up to the statutorily designated volumes, but that the suspensions would also be subject to price thresholds and would thus vary based on the price of production from the lease. See 65 Fed. Reg. 45,103 (2000); Admin. R. 189, 233-234; 62 Fed. Reg. 39,865-39,866 (1997); 61 Fed. Reg. 42,715 (1996). Consistent with those notices, each of the eight leases that respondent bid for, signed, and accepted contains a royalty-suspension provision subject to price thresholds. App., *infra*, 2a-3a, 13a, 26a-27a. The price thresholds are set at the amounts specified in 43 U.S.C. 1337(a)(3)(C)(v)-(vii) (governing new production in specified parts of the Gulf of Mexico under existing leases), with terms allowing adjustment for inflation. App., *infra*, 25a-28a. The leases require respondent to make royalty payments for any year in which the average price of oil or gas rises above the specified threshold. *Ibid.*

At various dates between 2002 and 2004, respondent began to produce oil and gas under each of the eight leases. App., *infra*, 30a. The price of gas exceeded the thresholds specified in the leases in both 2003 and 2004, and the price of oil exceeded the specified threshold in 2004. *Id.* at 4a, 31a-32a. Therefore, in a January 6,

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denda to the leases containing price threshold language but stopped for 2 years and instead cited a regulation that they thought contained threshold language, when, in fact, it did not. MMS's review process * * * simply failed to identify this discrepancy.").

2006 decision, the Department ordered respondent to pay royalties on the value of the oil and gas produced under the leases in those years. *Id.* at 4a, 23a-40a.

3. Respondent refused to pay the royalties as ordered and instead brought this action, claiming that the price-threshold provisions it accepted in its leases were contrary to Sections 304 of the Royalty Relief Act. App., *infra*, 2a, 18a-19a. On cross-motions for summary judgment, the district court granted judgment for respondent. *Id.* at 2a, 12a.

The district court relied primarily on the Fifth Circuit's earlier decision in *Santa Fe Snyder Corp.* v. *Norton*, 385 F.3d 884 (2004), which had invalidated part of the Department's regulations implementing Section 304.[5] The district court concluded that Congress did not provide the Secretary with the authority to impose price thresholds on leases issued for deepwater tracts in the Gulf of Mexico during the five years following enactment of the Royalty Relief Act. App., *infra*, 19a-21a. The district court concluded that Congress had specified a volume up to which royalties were to be suspended in Section 304 of the Royalty Relief Act, and that its doing

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[5] The Department had issued regulations that interpreted the suspension of royalties under Section 304 as applying only to leases issued in fields that had not produced oil or gas before the enactment of the Royalty Relief Act. See *Santa Fe Snyder*, 385 F.3d at 889. The Department's regulations also provided that the royalty-suspension volumes would be measured against the combined production from all leases in a field (rather than the production under each individual lease). *Ibid.* In *Santa Fe Snyder*, the Fifth Circuit held that those two aspects of the Department's regulations were contrary to the statute. According to the court, Sections 303 and 304, unlike Section 302, did not contain any "New Production Requirement," and Section 304 made the royalty-suspension volumes applicable on a lease-by-lease, rather than field-by-field, basis. *Id.* at 892-893.

so had removed the Secretary's authority under Section 303 to "vary" those suspensions on the basis of a price threshold. *Ibid.*

4. The court of appeals affirmed. App., *infra*, 1a-11a. Like the district court, the court of appeals relied heavily on its earlier decision in *Santa Fe Snyder*, in which it had considered the interplay between Sections 303 and 304 of the Royalty Relief Act. *Id.* at 8a-11a. The court of appeals began its analysis by noting that this case "is the logical and inevitable extension of *Santa Fe Snyder*" because, in the court's view, the Department sought to use a limitation on royalty relief present in Section 302 (which mandates price thresholds for new production under existing leases) to curtail the royalty relief provided in Section 304 for new leases, just as it had attempted to apply Section 302's "New Production Requirement" to Section 304 in *Santa Fe Snyder*. *Id.* at 9a. The court held that Section 304 "immediately excepts and replaces [the Secretary's] discretion [under Section 303 to vary the suspension on the basis of price thresholds] with a fixed royalty suspension." *Id.* at 10a (quoting *Santa Fe Snyder*, 385 F.3d at 892). The court thus concluded that Section 304's "statement that 'the suspension of royalties shall be set at a volume not less than' the specific production levels means just that: royalty payments shall be suspended up to the production volumes established by Congress"—without any further conditions or exceptions. *Ibid.* Because it found that "Section 304 is unambiguous in this regard," the court did not address whether the Department's contrary con-

struction of the statute is reasonable under "*Chevron*'s second step." *Ibid.*[6]

REASONS FOR GRANTING THE PETITION

The court of appeals' decision will likely cost the United States at least $19 billion in forgone or refunded royalties under several dozen leases that were issued under Section 304 of the Royalty Relief Act, and there is no meaningful likelihood that another court of appeals will have a chance to interpret the same federal statutory provisions. Notwithstanding the obvious importance of the case to the government, the court of appeals based its decision on a cursory examination of the statute, without even addressing the government's arguments about the statutory text and context. As Sections 302 and 303 of the Royalty Relief Act establish, the suspension of royalty payments for oil and gas at production below certain designated volumes can easily co-exist with a requirement that the lessee pay royalties on any oil or gas produced at times when prices exceed certain thresholds. The court of appeals erroneously read out of the statute Section 304's requirement to use the Section 303 bidding system—which includes the express authority to "vary" the suspension of royalties on the basis of such price thresholds (43 U.S.C. 1337(a)(1)(H)). The court's decision is contrary to the statutory language, and, at the very least, fails to give appropriate deference to the Department's reasonable interpretation. This Court should grant the petition for a writ of certiorari to consider an important question about the proper interpretation of a federal statute on which so many billions of dollars of federal revenue turn.

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[6] The court of appeals denied the government's petition for rehearing en banc. App., *infra*, 41a-42a.

A. The Court Of Appeals Incorrectly Interpreted The Royalty Relief Act And Failed To Give Appropriate Deference To The Department's Reasonable Interpretation

The court of appeals concluded (App., *infra*, 10a) that Congress's establishment of minimum production volumes for royalty suspensions in Section 304 of the Royalty Relief Act is unambiguously inconsistent with any residual discretion on the part of the Secretary to vary those royalty suspensions on the basis of price thresholds. But that understanding of the statute is flatly wrong. The Department's contrary interpretation is the best reading of the statute or, at the very least, a reasonable reading entitled to deference under *Chevron U.S.A. Inc.* v. *NRDC*, 467 U.S. 837 (1984).

1. Because this case raises questions "implicating an agency's construction of the statute which it administers," principles of *Chevron* deference control.[7] *INS* v. *Aguirre-Aguirre*, 526 U.S. 415, 424 (1999) (internal quotation marks omitted). If Congress has "directly spoken to the precise question at issue," "that is the end of the matter," but if the statute is "silent or ambiguous with respect to the specific issue," the agency's interpretation must be upheld so long as it is "a permissible construction of the statute." *Chevron*, 467 U.S. at 842-843.

In interpreting the Royalty Relief Act, the Department understood that the proper construction of Section 304 necessarily depends on the other provision to which it refers, Section 303 (43 U.S.C. 1337(a)(1)(H)). In regulations adopted approximately two months after the

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[7] Congress directed the Department to promulgate rules and regulations necessary to implement both OCSLA in general and the Royalty Relief Act in particular. See 43 U.S.C. 1334(a); RRA § 305, 109 Stat. 566.

RRA was enacted, the Department implemented Section 303 by acknowledging its discretionary authority to include price thresholds in any notices of lease sales. See 30 C.F.R. 260.110(a)(7) (1996); 61 Fed. Reg. 3804 (1996). It explained that the new bidding system would also apply to deepwater leases issued from 1996 to 2000 pursuant to Section 304. See *id.* at 3801. When administering the leasing program under Sections 303 and 304, the Department exercised its authority to specify price thresholds in notices of lease sales (including all of the notices concerning respondent's leases). See p. 7, *supra*. That construction was fully consistent with the best reading of Sections 303 and 304, and is certainly entitled to deference.

2. As outlined above (see pp. 4-5, *supra*), Section 303, which added a new bidding system to OCSLA, contains two relevant clauses. The first authorizes the Secretary to suspend the payment of royalties "for a period, volume, or value of production determined by the Secretary"; and the second states that those "suspensions may vary based on the price of production from the lease." 43 U.S.C. 1337(a)(1)(H). Section 304 then provides that, with regard to the leases issued from November 28, 1995 to November 28, 2000, the Secretary "shall use the bidding system authorized [by Section 303], except that the suspension of royalties shall be set at a volume of not less than" specified amounts. RRA § 304, 109 Stat. 565-566 (43 U.S.C. 1337 note entitled "Lease Sales").

Section 304's "except" clause limits the Secretary's discretion under the *first* clause of Section 303—by requiring the initial suspension to be set on the basis of a volume specified in Section 304 itself, rather than on the basis of a "period, volume, or value of production deter-

mined by the Secretary," as in Section 303, 43 U.S.C. 1337(a)(1)(H). But the "except" clause does not apply to the Secretary's discretion under the *second* clause of Section 303 to "vary" a suspension based on the price of production. That discretion carries over into Section 304 by virtue of the direction in that section that the Secretary "shall use the bidding system" authorized by Section 303. Thus, when Sections 303 and 304 are read together, as they must be, they allow the price thresholds included in respondent's leases. In other words, although Congress in Section 304 "set" minimum royalty suspension volumes, it otherwise incorporated Section 303, including its grant of authority to "vary" during lease administration the suspension volumes set by Congress. That conclusion is reinforced by the established principle that statutory exceptions are to be construed narrowly. *Commissioner* v. *Clark*, 489 U.S. 726, 739 (1989). Here, Congress "excepted" from the system described in Section 303 only the specification of volumes at which royalty suspensions were to be set in the first instance. Congress incorporated unchanged all the rest of that bidding system, including its authorization of variances based on the price of production.[8]

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[8] The relationship between Section 304 and the different portions of Section 303 is evident when Section 304's cross-reference is replaced by the language of Section 303 and Section 304's "except" clause then substituted for Section 303's parallel "suspension of royalties" provision. When thus integrated, as Congress directed, the provisions read as follows (with the language from Section 304 in brackets):

> [For all tracts located in water depths of 200 meters or greater in the Western and Central Planning Area of the Gulf of Mexico, including that portion of the Eastern Planning Area of the Gulf of Mexico encompassing whole lease blocks lying west of 87 degrees, 30 minutes West longitude, any lease sale within five years of the

3. The court of appeals rejected that straightforward interpretation of Section 304 on the ground that allowing royalty suspensions to "vary" based on the prices of oil and gas would "render [Section] 304's mandatory language meaningless" by effectively reducing the production volumes for which royalties are to be suspended. App., *infra*, 9a. But the court's objection is misplaced, and its resulting construction of Section 304 is refuted not only by the text, but also by the context and purpose of the Royalty Relief Act. See, *e.g.*, *Dolan* v. *USPS*, 546 U.S. 481, 486 (2006) (explaining that the "[i]nterpretation of a word or phrase depends upon reading the whole statutory text, considering the purpose and context of the statute").

a. In Sections 302 and 303—the provisions of the Royalty Relief Act dealing with new production under pre-existing deepwater leases in specified parts of the Gulf of Mexico (43 U.S.C. 1337(a)(3)(C)) and with new OCSLA leases generally (including the specified parts of the Gulf of Mexico for leases issued after November

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date of enactment of this title, shall use the] cash bonus bid with royalty at no less than 12 and ½ per centum fixed by the Secretary in amount or value of production saved, removed, or sold, and with suspension of royalties [set at a volume of not less than the following:

(1) 17.5 million barrels of oil equivalent for leases in water depths of 200 to 400 meters;

(2) 52.5 million barrels of oil equivalent for leases in 400 to 800 meters of water; and

(3) 87.5 million barrels of oil equivalent for leases in water depths greater than 800 meters],

which suspensions may vary based on the price of production from the lease.

That combined form gives effect to both the cross-reference to Section 303 and the "except" clause in Section 304.

28, 2000) (43 U.S.C. 1337(a)(1)(H))—Congress mandated or permitted the application of price thresholds even when the minimum production volumes associated with royalty relief have not been reached. See pp. 3-4, *supra*.

Indeed, in Section 302, Congress included mandatory suspension volumes that first appear to be unqualified, but that actually operate to set an initial suspension volume subject to variance depending on the price of oil and gas at the time of production. Section 302 provides that "*in no case* will [the suspension volumes] be less than [the same minimum volumes specified in Section 304]." 43 U.S.C. 1337(a)(3)(C)(ii) (emphasis added). But that seemingly absolute language cannot be read in isolation. Section 302 goes on to provide that—even "[d]uring the production" of the volumes up to which royalties would otherwise be suspended—the amounts of oil and gas that are produced are nevertheless "subject to royalties at the lease stipulated royalty rate" during years in which the average price of oil or gas rises above specified levels. 43 U.S.C. 1337(a)(3)(C)(v) and (vi). In addition, Section 302 expressly provides that "[a]ny production subject to" the price thresholds "shall be counted toward the production volume" for the royalty suspension, even though royalties must be paid on those production amounts. *Ibid.* Thus, the apparently mandatory royalty relief under Section 302 is compromised twice over. First, the relief does not apply to any amounts produced during periods when price thresholds are exceeded. Second, by counting against the production volume associated with the initial royalty suspension, the amounts produced at those times also reduce the amount of production that is subject to relief from royalties in future years. In other words, the royalty suspension *varies* as a result of the application of price thresholds.

By including in an overall scheme to determine royalty relief both mandatory suspension volumes and specified price thresholds, which can be applied in tandem to a single lease, Section 302 demonstrates that the two concepts are not mutually exclusive. To the contrary, as Section 303 also confirms, price thresholds—provisions that allow a suspension of royalties to "vary" according to the price of production—are fully compatible with the statute's specification of a volume at which a royalty suspension is initially set. They are also consistent with the very function of "variances," which provide for an exception from a general rule in circumstances in which the purposes of the rule do not apply. See, *e.g.*, *EPA* v. *National Crushed Stone Ass'n*, 449 U.S. 64, 76-77 (1980); see also pp. 17-18, *infra* (discussing the purposes of the RRA).

Section 304 is no different from Sections 302 and 303 in this regard. In Section 304, Congress required suspension of royalties at certain volumes and also required the Secretary to use the Section 303 bidding system—which includes the authorization to vary the congressionally set suspensions based on the price of oil and gas. That dual requirement is consistent with Congress's decision throughout the Royalty Relief Act to combine a system for *suspending* royalties with a system for *varying* those suspensions based on the price of oil and gas at the time of production. Such price thresholds serve to ameliorate the distortions that would occur at a time of high energy prices if royalty suspensions were based on volume of production alone.

Thus, given Sections 302 and 303, which expressly contemplate the applicability of *both* minimum volumes for royalty suspensions *and* price thresholds, the court of appeals erred in concluding (App., *infra*, 9a) that the

application of price thresholds under Section 304 would render suspension volumes "meaningless." As a result, the court misunderstood the import of Section 304's language mandating minimum volumes for royalty suspensions, interpreting it to carry a negative implication that other, linked sections of the statute expressly refute. In sum, the court failed to appreciate that the Royalty Relief Act as a whole, including Section 304, permits the Secretary to include price thresholds in leases that also include minimum suspension volumes.

b. The Department's interpretation is also consistent with the purposes of the Royalty Relief Act. No one disputes that for leases issued before November 28, 1995 and after November 28, 2000, Congress acted both to spur production and to protect the public fisc by offering suspended royalties but conditioning the suspensions on price thresholds. Thus, the Secretary is required to impose price thresholds for new production on existing leases that qualified for royalty relief. 43 U.S.C. 1337(a)(3)(C)(v) and (vi). And the Secretary is permitted to impose such price thresholds for new leases issued in the same geographic areas after Section 304's five-year period. 43 U.S.C. 1337(a)(1)(H).

It would, to say the least, be anomalous for Congress to have mandated price thresholds for existing leases, and to have authorized price thresholds for new leases in the future, and yet to have prohibited price thresholds, in the selfsame piece of legislation, during the five-year interim period addressed by Section 304. The purpose of the Royalty Relief Act was to create economic incentives for new production. Price thresholds are fully consistent with that goal, because the economic incentive of a royalty suspension is no longer necessary when the price of oil or gas rises sufficiently high. Indeed,

respondent bid on and entered into the very leases at issue here knowing that they contained such price thresholds. And at the point at which special economic incentives are no longer necessary, the purpose of protecting the public fisc through the collection of the standard royalties in the lease becomes paramount. See 43 U.S.C. 1344(a)(4) (OCSLA requires leasing activities "to assure receipt of fair market value for the lands leased and the rights conveyed by the Federal Government").

There is nothing in the text, structure, or purpose of the Royalty Relief Act to suggest that Congress intended for price thresholds to apply in every circumstance except for leases issued during the five-year period following enactment of the statute—and thereby to forgo billions of dollars in revenue otherwise due to the American public, and to bestow billions of dollars of windfalls on lessees when oil and gas prices are high.

B. There Will Be No Meaningful Opportunity For Further Interpretation Of The Royalty Relief Act In The Courts Of Appeals

Although there is no conflict in the circuits about the correct interpretation of Section 304 of the Royalty Relief Act, the unusual circumstances of the statute and its application all but guarantee that the Department's arguments will not be considered by other courts of appeals. By its terms, Section 304 applies only to leases issued for deepwater tracts on the outer Continental Shelf in certain portions of the Gulf of Mexico "lying west of 87 degrees, 30 minutes West longitude." 109 Stat. 565. Those areas are generally adjacent to Texas, Louisiana, and Mississippi, and the Department did not issue any leases under Section 304 for tracts that are within the territorial jurisdiction of any court of appeals

other than the Fifth Circuit. Additional litigation with other lessees about the payment of future royalties would be brought in the same way this case was: A lessee could challenge an order to pay royalties as contrary to law under the Administrative Procedure Act, 5 U.S.C. 706(2). As respondent did, other lessees could be expected to bring any future suits in the Fifth Circuit, given its holding that price thresholds are unambiguously beyond the agency's authority under Section 304 when minimum suspension volumes have not been reached.[9]

Although there is one plausible route to another court of appeals, it would be very unlikely to result in a circuit split reviewable by this Court and thus does not justify the denial of further review at this time. The Fifth Circuit's decision in *Santa Fe Snyder* noted that a lessee seeking a refund of royalties that had already been paid to the government should file suit in the Court of Federal Claims (for a claim involving more than $10,000), see 385 F.3d at 893, and such a suit could be appealed to the Federal Circuit, see 28 U.S.C. 1295(a)(3). As an initial matter, that scenario would require the Department to refuse to accept the Fifth Circuit's decision regarding payments already made under a lease within that court's jurisdiction, even as the Department would be effectively prevented from demanding any *additional* payments from the same lessee under the same lease term. Cf. *National Cable & Tele-*

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[9] In this case, respondent alleged venue (Compl. ¶ 10) under 28 U.S.C. 1392(e)(1) (which refers to the residence of the defendant) and 43 U.S.C. 1349(b)(1) (which allows a proceeding with regard to a case arising out of the production of minerals on the outer Continental Shelf to be "instituted in the judicial district in which any defendant resides or may be found, or in the judicial district of the State nearest the place the cause of action arose").

comms. Ass'n v. *Brand X Internet Servs.*, 545 U.S. 967, 984-985 (2005) (explaining that an appellate opinion that finds a statute "unambiguous" overrides an agency's contrary interpretation of the statute). And, in fact, if the Fifth Circuit's decision is allowed to stand, the Department does not intend under the circumstances to oppose refunds of royalties that were, under that court's reasoning, beyond its statutory authority to collect.[10] Moreover, even if such a suit were brought and appealed to the Federal Circuit, and if the government then prevailed, the Federal Circuit's decision would apply only to royalties that had already been collected, and the lessee could decide not to seek this Court's review, because the loss of royalties already paid could be more palatable than the possibility of having to pay royalties on all future production. If, on the other hand, the government were to lose in the Federal Circuit, there would still be no circuit split.

This Court should not rely on the speculative possibility of another appellate ruling under such circumstances. If the Court were to deny certiorari here, the Fifth Circuit's decision would likely be the final word interpreting Section 304 of the Royalty Relief Act. This case is therefore akin to those arising within the exclusive jurisdiction of the Federal Circuit, in which there is no realistic opportunity for another court of appeals to

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[10] In March 2008, after the district court's decision in this case, the Department advised parties making royalty payments not to adjust their prior or ongoing royalty payments until there is a final, non-appealable judgment. It also suggested that requests for refunds of royalties be made in the interim only when they might otherwise be barred by a statute of limitations. The Department would be particularly reluctant to refuse to refund royalties it collected on the basis of that letter.

address the questions raised. In such circumstances, the lack of a circuit split does not suffice to insulate the court of appeals' decision from this Court's certiorari jurisdiction. See Eugene Gressman et al., *Supreme Court Practice* 286-288 (9th ed. 2007).

C. If Allowed To Stand, The Court Of Appeals' Decision Will Cost The United States Treasury Billions Of Dollars In Lost Revenue

The court of appeals' decision presents an important question of federal statutory interpretation in part because, if allowed to stand, it will require the government to forgo many billions of dollars of revenue.

As Justice Scalia recently explained in a case in which a private party faced "a possible $1.4 billion judgment" and also had potentially $40 billion at stake in other pending class actions, "enormous potential liability, which turns on a question of federal statutory interpretation, is a strong factor in deciding whether to grant certiorari." *Fidelity Fed. Bank & Trust* v. *Kehoe*, 547 U.S. 1051, 1051 (2006) (Scalia, J., joined by Alito, J., concurring in the denial of certiorari); accord Gressman 269 ("The fact that especially large amounts of money are involved in litigation over the issue of statutory construction may also be a persuasive factor, though not always sufficient by itself unless the amount is enormous.").

In this case, the Department's 2006 order required respondent to pay approximately $36.2 million in royalties for production of oil and gas from eight leases in 2003 and 2004. Moreover, the Department estimates that another $159 million in royalties came due on production in 2005-2007 under the terms of those eight leases alone. But this is the least of the matter. Respondent

and its corporate affiliates have interests in ten other leases on which the Department estimates an additional $169.3 million in royalties came due on production through 2007. The court of appeals' decision will also govern the disposition of billions of additional dollars of potential federal revenue involving other lessees. There are 21 other pending administrative appeals of similar orders to pay royalties under Section 304 leases—appeals that have generally been held in abeyance pending resolution of this case. And some similarly situated lessees have continued to pay royalties during this litigation; as of June 30, 2009, the Department had collected an estimated $1.5 billion in royalties from leases issued in 1996, 1997, and 2000, the validity of which is called into doubt by the court of appeals' decision.

In addition to the royalties already due or paid, vastly more is at stake. The court of appeals' decision, if allowed to stand, will prevent the government from collecting royalties on oil and gas production in any future year in which the price thresholds are exceeded. As the Department recently informed Congress, its most recent predictions are that 83 leases from 1996, 1997, and 2000 will produce 2.46 to 2.7 billion barrels of oil equivalent before reaching the royalty-suspension volumes required by the court of appeals' decision. Letter from Richard T. Cardinale, Chief of Staff, Land & Minerals Mgmt., U.S. Dep't of the Interior, to Hon. Dianne Feinstein, Chairman, Subcomm. on Interior, Env't & Related Agencies, Senate Appropriations Comm., encl. 5b (Mar. 9, 2009). That would result in forgone future royalties estimated at $17.97 to $18.98 billion. *Ibid.* (The amount could, of course, be higher if either the amounts produced or the prices of oil and gas turn out to

be higher than the estimates that the Department used in making its forecast.[11])

Whatever the precise amount of forgone future royalties ultimately proves to be, the total cost will be huge, and it will have a direct, adverse affect on the Treasury of the United States. See 43 U.S.C. 1337(m) and 1338 (requiring royalties to be "deposited in the Treasury of the United States and credited to miscellaneous receipts"). And, correspondingly, those same sums will constitute huge and unjustified windfalls for respondent and other lessees that bid for, signed, and extracted federal oil and gas under leases that expressly provide for the very price thresholds they now seek to avoid. The "enormous" sum of federal revenue that turns on the "question of federal statutory interpretation" presented by this case is thus "a strong factor" counseling in favor of certiorari. *Fidelity Fed. Bank & Trust*, 547 U.S. at 1051 (Scalia, J., concurring in the denial of certiorari).[12]

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[11] In 2008, the Government Accountability Office conducted its own study of the 1996, 1997, and 2000 leases, and estimated that a loss in this case by the government would cost between $15.1 and $38.3 billion in forgone royalties from oil and gas production under 84 leases over the next 25 years. U.S. Gov't Accountability Office, *GAO-08-792R, Oil and Gas Royalties: Litigation Over Royalty Relief Could Cost the Federal Government Billions of Dollars* 8 (June 5, 2008) <http://www.gao.gov/new.items/d08792r.pdf>.

[12] This case is not in an interlocutory posture and thus does not present the circumstance that caused Justices Scalia and Alito to concur in the denial of certiorari in *Fidelity Federal Bank & Trust*. See 547 U.S. at 1051.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

ELENA KAGAN
Solicitor General
JOHN C. CRUDEN
Acting Assistant Attorney General
EDWIN S. KNEEDLER
Deputy Solicitor General
CURTIS E. GANNON
Assistant to the Solicitor General
MICHAEL T. GRAY
Attorney

JULY 2009

APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 08-30069

KERR-MCGEE OIL AND GAS CORP.,
PLAINTIFF-APPELLEE

v.

UNITED STATES DEPARTMENT OF INTERIOR;
C. STEPHEN ALLRED, ASSISTANT SECRETARY, ON
BEHALF OF LAND & MINERALS MANAGEMENT, ON
BEHALF OF UNITED STATES DEPARTMENT OF
INTERIOR, DEFENDANTS-APPELLANTS

Jan. 12, 2009

Before: KING, DENNIS and ELROD, Circuit Judges.

KING, Circuit Judge:

The Outer Continental Shelf Deep Water Royalty Relief Act authorizes the Department of the Interior to suspend the collection of oil and gas royalties from all new and preexisting federal, deepwater leases and to impose price or volume thresholds in order to determine when royalty payments should recommence. Additionally, for new deepwater leases issued between 1996 and 2000 for specific areas in the Gulf of Mexico, the act explicitly waives all royalty payments until a specific volume of oil or gas is produced. Kerr-McGee Oil and Gas

Corp. obtained eight new deepwater leases that, in addition to waivers based on volume, contained price thresholds set by the Department of the Interior. When oil and gas prices moved above those price thresholds, the Department of the Interior sought to collect royalties on these leases, despite the fact that the congressionally set volume thresholds had not yet been met. Kerr-McGee challenged the Department of Interior's order to pay royalties in the district court, which concluded on summary judgment that the agency did not have the authority to impose price thresholds requiring the payment of royalties on volumes less than the volume thresholds set by Congress. We agree and affirm the district court's decision for the following reasons.

I. FACTUAL AND PROCEDURAL BACKGROUND

The facts of this case are undisputed. Between 1996 and 2000, Kerr-McGee Oil and Gas Corp. ("Kerr-McGee") obtained eight deepwater, Gulf of Mexico mineral leases subject to royalty relief. These leases stipulated, however, that royalties would commence when certain price thresholds were met. Six of these leases employ the following language to impose such price thresholds:

> In any year during which the arithmetic average of the closing prices on the New York Mercantile Exchange for light sweet crude oil exceeds $28.00 per barrel, royalties on the production of oil must be paid . . . and production during such years counts toward the royalty suspension volume. In any year during which the arithmetic average of the closing prices on the New York Mercantile Exchange for natural gas exceeds $3.50 per million British thermal

> units, royalties on the production of natural gas must be paid . . . and production during such years counts toward the royalty suspension volume.

The remaining two leases contain substantially similar language:

> In any year during which the arithmetic average of the closing prices on the New York Mercantile Exchange (NYMEX) for light sweet crude oil exceeds $28.00 per barrel (threshold oil price), royalties on the production of oil must be paid . . . and production during such years counts toward the royalty suspension volume.
>
> In any year during which the arithmetic average of the closing prices on the NYMEX for natural gas exceed $3.50 per million British thermal units (threshold gas price), royalties on the production of natural gas must be paid . . . and production during such years counts toward the royalty suspension volume.[1]

All eight leases are additionally subject to the volume thresholds established by § 304 of the Outer Continental Shelf Deep Water Royalty Relief Act (the "DWRRA"), which states:

> For all tracts located in water depths of 200 meters or greater in the Western and Central Planning Area of the Gulf of Mexico, including that portion of the Eastern Planning Area of the Gulf of Mexico encompassing whole lease blocks lying west of 87 degrees, 30 minutes West longitude, any lease sale within five years of the date of enactment of this title, shall use the bidding system authorized in section 8(a)(1)(H)

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[1] Both leases adjust the triggering prices for inflation.

of the Outer Continental Shelf Lands Act, as amended by this title, except that the suspension of royalties shall be set at a volume of not less than the following:

(1) 17.5 million barrels of oil equivalent for leases in water depths of 200 to 400 meters;

(2) 52.5 million barrels of oil equivalent for leases in 400 to 800 meters of water; and

(3) 87.5 million barrels of oil equivalent for leases in water depths greater than 800 meters.

Pub. L. No. 104-58, 109 Stat. 557 (uncodified, but present in a note to 43 U.S.C. § 1337).

In 2003, the average annual price of natural gas exceeded the leases' inflation-adjusted price threshold. In 2004, the average annual prices of both oil and gas exceeded the respective price thresholds for those commodities. Not one of the leases, however, had enjoyed production that triggered the volume thresholds imposed by § 304.

Based on the triggered price thresholds, the United States Department of the Interior ("Interior") issued a final agency order (the "Burton Decision"). The Burton Decision informed Kerr-McGee that the oil and gas price thresholds had been exceeded, concluded that Interior had authority to suspend royalty relief based on price thresholds triggered before production exceeded § 304's volume thresholds, and directed Kerr-McGee to pay royalties.

Kerr-McGee challenged the Burton Decision in federal district court, and, on summary judgment, the court ruled that Interior did not have the authority to suspend

royalty relief for production at volumes less than those established by Congress. Interior brought this timely appeal, arguing that the DWRRA does not alter the agency's discretionary authority to vary royalty relief by imposing price thresholds that suspend royalty relief before § 304's volume thresholds are exceeded.

II. STANDARD OF REVIEW

We review de novo a grant of summary judgment, applying the same legal standards that the direct court applied. *Kornman & Assocs., Inc. v. United States*, 527 F.3d 443, 450 (5th Cir. 2008). Summary judgment is proper when the evidence reflects "no genuine issue as to any material fact and that the movant is entitled to judgment as a matter of law." FED. R. CIV. P. 56(c).

An agency's interpretation of its statutory authority is reviewed according to the two-step inquiry established in *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 104 S. Ct. 2778, 81 L. Ed. 2d 694 (1984). *Med. Ctr. Pharmacy v. Mukasey*, 536 F.3d 383, 393 (5th Cir. 2008). First, we "must give effect to the unambiguously expressed intent of Congress" if Congress has, indeed, "directly spoken to the precise question at issue." *Id.* (internal quotation marks omitted). If we determine that the statute is ambiguous, then we proceed to *Chevron*'s second step and "'reverse [an] agency's decision only if it [is] arbitrary, capricious, or manifestly contrary to the statute.'" *Id.* (quoting *Tex. Coal. of Cities for Util. Issues v. FCC*, 324 F.3d 802, 807 (5th Cir. 2003)) (alterations in original).

III. DISCUSSION

Under *Chevron's* first step, we must consider whether Congress unambiguously granted Interior the authority to suspend royalty relief at production volumes less than those established by § 304. To interpret the statute, we begin by looking at its plain text. *Wheeler v. Pilgrim's Pride Corp.*, 536 F.3d 455, 458 (5th Cir. 2008). The DWRRA contains three operative sections, and, because "it is a cardinal rule that a statute is to be read as a whole," *In re Supreme Beef Processors, Inc.*, 468 F.3d 248, 253 (5th Cir. 2006) (en banc), we describe each section in turn. The first section applies only to leases in existence prior to the act's effective date and states:

> (i) [N]o royalty payments shall be due on new production . . . from any lease or unit located in water depths of 200 meters or greater in the [same geographic region of the Gulf of Mexico specified in § 304] until such volume of production as determined pursuant to clause (ii) has been produced by the lessee.
>
> (ii) Upon submission of a complete application by the lessee, the Secretary [of Interior] shall determine . . . whether new production from such lease or unit would be economic in the absence of the relief from [royalties]. . . . If the Secretary determines that such new production would be economic in the absence of the relief from [royalties] . . . the Secretary must determine the volume of production from the lease or unit . . . in order to make such new production economically viable; except that for new production . . . in no case will that volume be less than 17.5 million barrels of oil equivalent in water

depths of 200 to 400 meters, 52.5 million barrels of oil equivalent in 400-800 meters of water, and 87.5 million barrels of oil equivalent in water depths greater than 800 meters. . . .

* * *

(v) During the production of volumes determined pursuant to clause[ ] (ii) . . . in any year during which the arithmetic average of the closing prices on the New York Mercantile Exchange for light sweet crude oil exceeds $28.00 per barrel, any production of oil will be subject to royalties. . . .

(vi) During the production of volumes determined pursuant to clause[ ] (ii) . . . in any year during which the arithmetic average of the closing prices on the New York Mercantile Exchange for natural gas exceeds $3.50 per million British thermal units, any production of natural gas will be subject to royalties. . . .

DWRRA § 302, 43 U.S.C. § 1337(a)(3)(C). The DWRRA's next section authorizes a new bidding method that Interior may use in leasing any of the submerged lands of the Outer Continental Shelf. It provides that bidding may be on the basis of a:

cash bonus bid with royalty at no less than 12 and 1/2 per centum fixed by the Secretary in amount or value of production saved, removed, or sold, and with suspension of royalties for a period, volume, or value of production determined by the Secretary, which suspensions may vary based on the price of production from the lease. . . .

Id. § 303, 43 U.S.C. § 1337(a)(1)(H). The DWRRA's final section, set forth in full above, specifically addresses new, deepwater leases sold in a specific region of the Gulf of Mexico between 1996 and 2000. The pertinent language of that section states that "the suspension of royalties shall be set at a volume of not less than the following" specifically established volume thresholds. *Id.* § 304, Pub. L. No. 104-58, 109 Stat. 557 (uncodified, but present in a note to 43 U.S.C. § 1337).

Looking to *Santa Fe Snyder Corp. v. Norton*, 385 F.3d 884 (5th Cir. 2004), the district court concluded that Interior did not have the authority to suspend royalty relief for new leases at production volumes less than those set by Congress in § 304. In *Santa Fe Snyder*, we considered whether Congress granted Interior the authority to limit the application of § 304's royalty relief to only those new leases that resulted in new production from a field. *Id.* at 889-90.[2] Under *Chevron*'s first step, we stated that the question was "whether Section 304 of the [DW]RRA unambiguously provides that royalty suspensions apply in full to each [n]ew [l]ease qualifying under its terms," which we answered affirmatively. *Id.* at 890, 892. In doing so, we juxtaposed the economic justification required for existing leases to obtain royalty relief under § 302—the new production requirement—with the limited, objective requirements to obtain royalty relief for new leases under § 304—water-depth and

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[2] A "field" is "an area consisting of a single reservoir or multiple reservoirs all grouped on, or related to, the same general geological structural feature and/or stratigraphic trapping condition." *Id.* at 889 (internal quotation marks omitted). The new production prerequisite required a lessee to show that no oil or gas had yet been produced from anywhere in the field before obtaining royalty relief. *See id.* at 889-90.

location. *See id.* at 892-93 ("Congress clearly imposed a New Production Requirement on [e]xisting [l]eases. It did not do so for [n]ew [l]eases.").

The current case is the logical and inevitable extension of *Santa Fe Snyder*, as the district court correctly reasoned. Here, as in that case, Interior seeks to employ a royalty-relief limitation present in § 302 (which applies to leases existing prior to the DWRRA's enactment) in order to limit the royalty relief granted to new leases by § 304. Interior asserts that § 304's reference to § 303's bidding process nonetheless grants Interior the discretion to "vary" the suspension of § 304's royalty relief based on the prices of oil and gas.[3] But the plain language of the statute does not bear Interior's interpretation. Section 304 states that "the suspension of royalties shall be set a volume not less than" the stated production volumes. Interior's reading would render § 304's mandatory language meaningless: if price thresholds trigger royalty payments before § 304's production volumes are exceeded, then the royalty payment suspension *is* being set at a volume less than § 304's specified production levels. While § 303 grants Interior discretion to "vary" royalty relief for all new leases of submerged lands on the Outer Continental Shelf based

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[3] We note that, below, Interior raised the affirmative defense that Kerr-McGee should be estopped from challenging the legality of the price thresholds because the company bid on and signed leases containing these provisions. The district court ruled that this defense was unavailable because government officials cannot enforce by estoppel a contract that they were not legally authorized to make. *See LaBarge Prods., Inc. v. West*, 46 F.3d 1547, 1552 (Fed. Cir. 1995). In its briefs to this court, Interior does not contend that any such affirmative defense applies; therefore, it has abandoned this argument. *See Fuzy v. S & B Eng'rs & Constructors, Ltd.*, 332 F.3d 301, 302 (5th Cir. 2003).

on the price of production, § 304 "immediately excepts and replaces Interior's discretion with a fixed royalty suspension for [n]ew [l]eases on a volume basis" where those new leases are located in the geographic region specified by § 304. *Id.* at 892. Had Congress intended to impose price thresholds on the royalty relief for these new leases, it certainly knew how to do so. *See, e.g.*, DWRRA § 302 (specifically setting price thresholds on royalty relief for existing leases that qualify for royalty relief); *see also* Royalty Relief for American Consumers Act of 2006, H.R. 4749, 109th Cong. § 2(a) (2006) (proposed legislation seeking to suspend all royalty relief if specified price thresholds are met). However, Congress refrained from specifically establishing such price thresholds, and we refuse Interior's invitation to read this royalty-relief limitation into the statute.

Thus, the plain language of § 304 dictates our conclusion in this case just as it did in *Santa Fe Snyder*. The statement that "the suspension of royalties shall be set at a volume not less than" the specific production levels means just that: royalty payments shall be suspended up to the production volumes established by Congress. Section 304 is unambiguous in this regard, and it does not grant Interior the authority to impose price thresholds that suspend royalty relief at production volumes less than those established by Congress in § 304. Therefore, we need not extend our analysis to *Chevron*'s second step.

Finally, Interior makes the same argument that it made in *Santa Fe Snyder* regarding the DWRRA's legislative history. *See* Federal Defendants-Appellants' Opening Brief at 27-29, *Sante Fe Snyder*, 385 F.3d 884 (No. 03-30648); Federal Defendants-Appellants' Reply

Brief at 14-16, *Sante Fe Snyder*, 385 F.3d 884 (No. 03-30648). Kerr-McGee points to competing passages in the legislative history in support of its position. But as we stated in *Santa Fe Snyder*, "[b]ased on our conclusion that the statutory language is unambiguous, we need not follow the Interior's suggestion to look to legislative history as a guide in interpreting the [statute]." 385 F.3d at 893.

IV. CONCLUSION

For the foregoing reasons, we AFFIRM the judgment of the district court.

APPENDIX B

UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF LOUISIANA
LAKE CHARLES DIVISION

No. 2:06 CV 0439

KERR-MCGEE OIL & GAS CORP.

v.

C. STEPHEN ALLRED, ASSISTANT SECRETARY FOR LAND & MINERALS MGT., AND THE DEPT. OF THE INTERIOR

[Filed: Oct. 30, 2007]

MEMORANDUM RULING

PATRICIA MINALDI, United States District Judge.

Before the court is plaintiff Kerr-McGee Oil & Gas Corp.'s ("Kerr-McGee") Motion for Summary Judgment and C. Stephen Allred and the Department of the Interior's ("the Interior") Cross-Motion for Summary Judgment.[1]

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[1] Pl.'s Mot. for Summary Judgment [doc. 28]; Def.'s Cross-Mot. for Summary Judgment [doc. 39].

FACTS

Congress enacted the Outer Continental Shelf Deepwater Royalty Relief Act of 1995 ("DWRRA"), codified at 43 U.S.C. § 1337, to encourage the exploration of oil and gas in the Gulf of Mexico's deepwater, where the risks and costs of operation were high.[2] Kerr-McGee has invested over $3.5 billion to develop deepwater leases in the Gulf.[3] The eight deepwater leases for which Kerr-McGee was ordered to pay royalties contain language that makes mandatory royalty relief[4] subject to specified price thresholds.[5]

On January 6, 2006, Acting Assistant Secretary Burton signed an Order directing Kerr-McGee to pay royalties on natural gas it produced in 2003, and on both oil and natural gas produced in 2004, for eight leases Kerr-McGee operated under the DWRRA.[6] The Burton Decision found that the average annual price of natural gas

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[2] S. Rep. No. 103-248, at 3-4 (1994).

[3] Pl.'s Compl. ¶ 2.

[4] The DWRRA of 1995 eliminates the Secretary's discretion to set the volume of royalty suspension for leases enacted between November 28, 1995 and November 28, 2000. 43 U.S.C. § 1337(a)(3)(C)(i).

[5] Under the terms of the lease between Kerr-McGee and the Interior, Kerr-McGee makes royalty payments to the Interior if the commodity price of oil or case [*sic*] exceeds a prescribed threshold level (a "price threshold"), even when the lease has not yet produced the volume of oil and gas that was to be royalty-free under the DWRRA. United States Department of Interior, Order to Report and Pay Royalties and Interest Due Under Identified Offshore Federal Oil and Gas Leases (Jan. 6, 2006) ("The Burton Decision"), at 2-4. The Burton Decision is so named because it was signed by Acting Assistant Secretary Burton. *Id.* at 11.

[6] *Id.* at 10.

was in excess of the price threshold for 2003 and 2004, and the average annual price of oil was in excess of the price threshold in 2004.[7] The Burton Decision is a final agency action subject to judicial review.[8] On March 17, 2006, Kerr-McGee filed for declaratory judgment and injunctive relief against the Department, challenging the Burton Decision.[9]

BACKGROUND OF THE CONTROLLING STATUTES AND THE BURTON DECISION

This action arises under the Administrative Procedure Act ("APA"), 5 U.S.C. § 701 *et seq.*, the Outer Continental Shelf Lands Act ("OCSLA"), 43 U.S.C. § 1331 *et seq.*, and the DWRRA, 43 U.S.C. § 1337.

A.) The OCSLA

The OCSLA gives the Secretary of the Interior the authority to issue and administer oil and gas leases on the outer continental shelf and to promulgate implementing regulations. 43 U.S.C. § 1334(a). The Minerals Management Service ("MMS") administers the OCS leasing program by conducting lease sales. Pursuant to the OCSLA, the typical royalty for offshore deepwater leases is one-sixth. *Id.*

B.) The DWRRA

The DWRRA amended the OCSLA and gave the Secretary the authority to suspend royalties on certain volumes of initial production from the deepest areas of the Gulf. 43 U.S.C. § 1337(a)(3)(C)(i) & (ii). The DWRRA

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[7] *Id.*

[8] *Id.* at 11.

[9] Pl's Compl.

established three specific schemes for royalties from deepwater leases. *Id.* § 1337(a)(3)(C)(v)-(vii).

First, companies with leases existing on November 28, 1995 were not exempt from paying on new production until the volume exceeded the prescribed price threshold level. *Id.* Section 302 permits existing lessees to apply for royalty relief, which the Secretary would award if the lease would otherwise not be economic. *Id.* § 1337(a)(3)(C)(ii). Additionally, Section 302 expressly provides that no royalty relief is allowed if the price of oil or gas meets a price threshold, as statutorily defined by Congress. *Id.* § 1337(a)(3)(C)(v)-(vi). MMS implemented price threshold provisions for these leases. 30 C.F.R. § 203.78.

Second, Congress required the Interior to provide royalty relief to leases enacted between November 28, 1995 and November 28, 2000 ("Mandatory Royalty Relief Leases"). 43 U.S.C. § 1337 (Note); *see also Sante Fe Snyder Corp. v. Norton*, 385 F.3d 884 (5th Cir. 2004). Mandatory Royalty Relief Leases are governed by the bidding system authorized in Subparagraph H of § 1337. *Id.* § 1337(a)(1)(H). In Section 304, however, Congress "immediately excepts and replaces Interior's discretion [under Section 303] with a fixed royalty suspension. . . ." *Santa Fe Snyder*, 385 F.3d at 892 (noting that under Pub. L. 104-58, § 304, royalties are suspended for specific volumes and water depths). Eight of Kerr-McGee's Mandatory Royalty Relief Leases are at issue in this suit.

Third, leases issued after the five-year period ended on November 28, 2000 are governed by Section 303, and the Secretary is authorized to provide royalty relief and to impose price thresholds. 43 U.S.C. § 1337(a)(3)(C).

C.) The Burton Decision

The Burton Decision interpreted Section 304 of the DWRRA as it applied to Kerr-McGee's eight deepwater leases, and found that Kerr-McGee owed the Interior royalties from these leases because price thresholds were satisfied. The Burton Decision at 4. The Burton Decision found that the royalty relief available to the eight Kerr-McGee leases was limited by price thresholds contained in the terms of the leases, imposed pursuant to Congressional authority. *Id.* The Burton Decision rejected Kerr-McGee's argument that Mandatory Relief Leases are not subject to price thresholds below the minimum volume of royalty-free production. *Id.*

The Burton Decision first rejected Kerr-McGee's interpretation of *Santa Fe Snyder*, stating that *Santa Fe Snyder* did not discuss price thresholds and is therefore not a basis for Kerr-McGee to avoid enforcement of the price threshold provisions in its leases. *Id.* Thus, the Burton Decision found that the price threshold provisions promulgated in 1337(a)(1)(H) apply to leases executed between November 28, 1995 and November 28, 2000, and therefore apply to Kerr-McGee's leases, regardless of whether minimum volume of royalty-free production was first produced. The Burton Decision also applied the price thresholds to assess how much money Kerr-McGee owes the Department. *Id.* at 4-8.

STANDARD OF RELIEF

Courts review agency action under the APA by first determining whether the agency decision was "arbitrary, capricious, an abuse of discretion, or otherwise not in accorance with law; [or] . . . in excess of statutory jurisdiction, authority, or limitations, or short of

statutory right." 5 U.S.C. § 706(2)(A). When reviewing an agency action, a court first determines:

> [w]hether Congress has directly spoken to the precise question at issue. If the intent of Congress is clear, that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress. If, however, the court determines that Congress has not addressed the precise question at issue . . . the question for the court is whether the agency's answer is based upon a permissible construction of the statute.

Chevron U.S.A., Inc. v. Natural Res. Def. Counsel, 467 U.S. 837, 842-43 (1984). "In reaching a determination whether Congress has spoken directly on an issue, courts are free to consider both the plain language and meaning of the statute and any pertinent legislative history." *Ghiglieri v. Sun World Nat'l Ass'n*, 117 F.3d 309, 313 (5th Cir. 1997).

Under *Chevron*'s second prong, if a court finds the statute ambiguous, the court examines whether "the agency's answer is based upon a permissible construction of the statute." *Chevron*, 467 U.S. at 843. An agency is entitled to "substantial deference" when interpreting its own regulations, and, accordingly, the agency interpretation must be followed unless it is plainly wrong or inconsistent with the regulation. *Thomas Jefferson Univ. v. Shalala*, 512 U.S. 504, 512 (1994). "It is elementary administrative law that an agency must operate within the confines of its own regulations." *Am. Petroleum Inst. v. E.P.A.*, 787 F.2d 965, 975 (5th Cir. 1986).

A court should grant a motion for summary judgment when the file demonstrates that "there is no genu-

ine issue of material fact and that the moving party is entitled to a judgment as a matter of law." FED. R. CIV. P. 56(c); *Celotex Corp. v. Catrett*, 477 U.S. 317, 323-24 (1986). The party moving for summary judgment is initially responsible for demonstrating the reasons justifying the motion for summary judgment by identifying portions of pleadings and discovery that demonstrate the lack of a genuine issue of material fact for trial. *Tubacex, Inc. v. M/V Risan*, 45 F.3d 951, 954 (5th Cir. 1995). The court must deny the moving party's motion for summary judgment if the movant fails to meet this burden. *Id.* If the movant satisfies this burden, however, the nonmoving party must "designate specific facts showing that there is a genuine issue for trial. *Id.*

ANALYSIS

The crux of this case is whether Section 304, which requires mandatory royalty relief for specified volumes, also stripped the Interior of its discretion to set price thresholds that would apply before a Mandatory Relief Lease produced the minimum volume of royalty-free production. Kerr-McGee contends that Mandatory Relief Leases are not subject to price thresholds below the minimum volume of royalty-free production, whereas the Department argues it retained the discretion to set price thresholds below the minimum volume of royalty-free production.

A.) Chevron Review of the Burton Decision

Kerr-McGee contends that the Burton Decision is unlawful under the first step of *Chevron*, because Congress clearly articulated its intent to establish mandatory royalty relief for specified volumes in the DWRRA.

Kerr-McGee argues that the DWRRA's mandatory royalty relief provision, Section 304, also prevents the Interior from enacting price thresholds for volumes below the minimum volume articulated in the DWRRA. Accordingly, Kerr-McGee maintains that the Burton Decision was contrary to law because the defendants conditioned royalty relief in Kerr-McGee's Mandatory Relief Leases upon commodity prices for oil and gas remaining below price thresholds.[10]

The Interior argues that the DWRRA clearly established the authority of the Interior to establish price thresholds on new leases. The Interior argues that Section 304 did not deprive the agency of its ability to establish price thresholds because Section 304 specifies the use of the Section 303 bidding system, which permits price thresholds, and nothing in Section 304 removes the authority for price thresholds. Thus, the Interior argues that price thresholds are permissible. Moreover, the Interior argues that *Santa Fe Synder* should be limited to its holding that leases enacted between 1996-2000 contained mandatory royalty relief for minimum volumes of production. The Interior argues that *Santa Fe Snyder* does not preclude the imposition of price thresholds below the minimum volumes for which royalty relief was to be mandatory.

The Fifth Circuit interpreted Sections 303 and 304 of the DWRRA as they pertain to new production requirements for Mandatory Royalty Relief leases. *Santa Fe Snyder*, 385 F.3d at 883-84. Section 303 added a new bidding system that gave the Interior the authority to lease any water depth in any location with royalty relief

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[10] Pl.'s Compl. 13-14.

fashioned according to the Interior's discretion. 43 U.S.C. § 1337(a)(1)(H). The *Santa Fe Snyder* court found that this power, however, was tempered by the next section, where Congress replaced the Interior's discretion to fashion royalty relief with a fixed royalty suspension scheme based on volume and water depth. 385 F.3d at 892; *see also* 43 U.S.C. § 1337 (Note). Thus, the royalty relief for Mandatory Royalty Relief leases is automatic and unconditional.

The *Santa Fe Snyder* court found that Section 304 clearly articulated Congress's unambiguous intent that a suspension of royalties shall be set at the volume levels provided for in the statute. 385 F.3d at 892-93 (Section 304 dictates that "the suspension of royalties shall be set at a volume of not less than [states differing amounts varying on water depth]"). In interpreting Section 304, the *Santa Fe Snyder* court held that:

> Section 304 mandates that, without exception, based only on the objective factors of water depth, location of the lease block and date of the lease sale, all leases meeting these objective criteria are entitled to receive the suspensions of royalties benefit, which the Secretary may not set at a volume less than the particular volume assigned for each water depth. The statute is unambiguous on this point.

Id. at 891. The *Santa Fe Snyder* court found that the Interior's addition of a new production requirement was contrary to law and thus the Fifth Circuit did not proceed beyond *Chevron*'s first step. *Id.* at 892-93.

The price threshold requirement found in Kerr-McGee's Mandatory Royalty Relief leases is similarly unlawful under the plan text of the DWRRA because

DWRRA's Section 304, applying to new leases, clearly requires minimum royalty relief. The Interior has no discretion to enact a price threshold requirement that applies to volumes below the minimum volume of royalty-free production. Because the Interior imposed price threshold requirements on Kerr-McGee's eight deepwater leases that would require Kerr-McGee to pay millions of dollars in royalties before it had even produced the minimum volume of royalty-free production, the Interior exceeded its Congressional authority. Thus, under *Chevron*'s first step, the Interior's action is unlawful because it contradicts the plain, unambiguous text of the statute.

B.) The Interior's Affirmative Defenses

The Interior argues that even if the agency action was contrary to law, several affirmative contractual defenses apply that nonetheless require Kerr-McGee to pay royalties in accordance with the price threshold language in its contract. Both parties now agree that the first two defenses are moot. The remaining three defenses that the Interior proffers are: 1.) estoppel, 2.) waiver, and 3.) mutual mistake. The Interior is not moving for summary judgment on the remaining three defenses, and contends that there are outstanding issues of material fact that preclude summary judgment on these defenses. Kerr-McGee does, however, move for summary judgment as a matter of law on these defenses.

It is well settled that "if government officials make a contract they are not authorized to make, in violation of a law enacted for the contractor's protection, the contractor is not bound by estoppel, acquiescence, or failure to protest." *LaBarge Products Inc. v. West*, 46 F.3d

1547, 1552 (Fed. Cir. 1995); *see also Tesoro Hawaii Corp. v. United States*, 405 F.3d 1339 (Fed. Cir. 2005) (holding that the Government's defenses of estoppel and waiver did not apply because such remedies are not available when the government makes illegal contracts). The Interior also argued contractual defenses applied in *Santa Fe Snyder*, but the *Santa Fe* court rejected these arguments, noting that the issue of mandatory relief levels was based on statutory interpretation, not contractual interpretation. *Id.*

Because contractual defenses are not available when the Government makes a contract contrary to law, the Interior's affirmative defenses are unavailing. Accordingly, Interior's affirmative defenses will be dismissed as a matter of law.

Lake Charles, Louisiana, this 18 day of October 2007.

/s/ P MINALDI
PATRICIA MINALDI
United States District Judge

APPENDIX C

United States Department
of the Interior

OFFICE OF THE SECRETARY
Washington, DC 20240

JAN 6 2006

CERTIFIED MAIL—
RETURN RECEIPT REQUESTED

Dennis Bardin
Supervisor of Regulatory Accounting
Kerr-McGee Oil and Gas Corporation
16666 Northchase
Houston, TX 77060-6001

Re: Order to Report and Pay Royalties and Interest Due under Identified Offshore Federal Oil and Gas Leases

Dear Mr. Bardin:

The Department of the Interior hereby orders Kerr-McGee Oil and Gas Corporation ("Kerr-McGee") to calculate, report, and pay royalties on production from the following Federal offshore leases located on the Gulf of Mexico outer Continental Shelf, as explained more fully below:

Lease Number	Block
0540222950	East Breaks Block 689
0540222960	East Breaks Block 690
0540190840	Garden Banks Block 197
0540190280	East Breaks Block 599
0540174060	Garden Banks Block 667
0540174070	Garden Banks Block 668
0540174080	Garden Banks Block 669
0540173070	Garden Banks Block 201

The eight leases listed above will be referred to collectively as the "Kerr-McGee Leases."

Background

A. Section 304 of the Deep Water Royalty Relief Act of 1995 and the Decision of the Fifth Circuit in *Santa Fe Snyder Corp., et al.* v. *Norton*

On six separate dates (February 14, 2003; March 19, 2003; January 20, 2004; February 26, 2004; March 12, 2004; and December 14, 2004), the Minerals Management (MMS), Gulf of Mexico Region, notified you that the Kerr-McGee Leases qualified for royalty relief under section 304 of the Deep Water Royalty Relief Act of 1995 (DWRRA), Pub. L. No. 104-58, 109 Stat. 563, 565, 43 U.S.C. § 1337 note, and implementing regulations in 30 C.F.R. §§ 260.113 - 260.117 (2001-present).[1]

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[1] Predecessor rules implementing DWRRA section 304 were codified to the former 30 C.F.R. § 260.110(d) (1996-2000).

Section 304 required the Secretary of the Interior to use the bidding system of section 8(a)(1)(H) of the Outer Continental Shelf Lands Act of 1953, 43 U.S.C. § 1337(a)(1)(H) (added by DWRRA section 303, 109 Stat. 565), in all sales of deep water leases conducted within the first 5 years after the date of the DWRRA's enactment (*i.e.*, during the period between November 28, 1995, and November 28, 2000). The Kerr-McGee Leases were issued under section 304. Section 304 was discussed in the decision of the United States Court of Appeals for the Fifth Circuit in *Santa Fe Snyder Corp., et al. v. Norton*, 385 F.3d 884 (5th Cir. 2004). That case involved a challenge to certain of the Department's regulations implementing section 304 that affected the calculation of royalty suspension volumes if a section 304 lease was assigned to a field that was producing before the DWRRA was enacted or if a field included more than one section 304 lease.

B. Price Threshold Lease Terms for Leases Issued in 1996, 1997, and 2000

Leases issued under section 304 in the lease sales held in 1996, 1997, and 2000, including the Kerr-McGee Leases, make the royalty relief discussed above subject to specified price thresholds. The price thresholds apply regardless of whether a lease is part of a field that produced before November 28, 1995 (the DWRRA's enactment) or is part of a larger field with more than one section 304 lease. The price thresholds are incorporated in the express terms of the lease and in the terms of the notices of sale under which the leases were issued.

The lease terms provide that if the arithmetic average of the closing prices on the New York Mercantile Ex-

change ("NYMEX") for crude oil or natural gas exceeds a specified level in any year, the lessee must pay royalties at the rate stipulated in the lease on all oil or gas produced during the year. (The year refers to any calendar year, and the threshold prices are adjusted in subsequent years for inflation by the GDP implicit price deflator.) That production also counts against the section 304 royalty suspension volume.

Specifically, for the Kerr-McGee Leases issued in Lease Sale 161 (Lease nos. 0540174060, 0540174070, 0540174080, and 0540173070) and in Lease Sale 168 (Lease nos. 0540190840 and 0540190280), the lease terms at Lease Addendum paragraph k provide:

> In any given year during which the arithmetic average of the closing prices on the New York Mercantile Exchange for light sweet crude oil exceeds $28.00 per barrel, royalties on the production of oil must be paid at the lease stipulated royalty rate, and production during such years counts toward the royalty suspension volume. In any year during which the arithmetic average of the closing prices on the New York Mercantile Exchange for natural gas exceeds $3.50 per million British thermal unit, royalties on the production of natural gas must be paid at the lease stipulated royalty rate, and production during such years counts toward the royalty suspension volume. These prices for oil and natural gas are as of the end of 1994 and must be adjusted for subsequent years by the percentage by which the implicit price deflator for the gross domestic product changed during the preceding calendar year.

For the Kerr-McGee Leases issued in Lease Sale 177 (Lease nos. 0540222950 and 0540222960), lease terms at Lease Addendum section 6 provide:

> In any year during which the arithmetic average of the closing prices on the New York Mercantile Exchange (NYMEX) for light sweet crude oil exceeds $28.00 per barrel (threshold oil price), royalties on the production of oil must be paid at the lease stipulated royalty rate, and production during such years counts toward the royalty suspension volume.
>
> In any year during which the arithmetic average of the closing prices on the NYMEX for natural gas exceeds $3.50 per million British thermal units (threshold gas price), royalties on the production of natural gas must be paid at the lease stipulated royalty rate, and production during such years counts toward the royalty suspension volume.
>
> These prices for oil and natural gas are as of 1994 and must be adjusted for subsequent years by the percentage by which the implicit price deflator for the gross domestic product changed during the preceding calendar year. For 1999, the threshold oil price was $30.40, compared to a $19.26 average NYMEX oil price in 1999. For 1999, the threshold gas price was $3.80, compared to $2.31 average NYMEX gas price in 1999.

The substantive meaning of both of the quoted lease terms is identical.

Under these lease terms, MMS' Offshore Minerals Management ("OMM") computes the price threshold in any particular year for the Kerr-McGee Leases using the

year over year (*i.e.*, current year/previous year) GDP Implicit Price Deflator to calculate the applicable inflation rate. The inflation rate is multiplied by the price threshold for the previous year. For example, to calculate the 2004 oil price threshold of $33.55, divide the Implicit Price Deflator for 2004 (108.22) by the Implicit Price Deflator for 2003 (106.00) and multiply that result by the price threshold for 2003 ($32.86).

The price thresholds derive from specific authority granted in 43 U.S.C. § 1337(a)(1)(H). As mentioned above, section 304 requires the Secretary to use the bidding system of section 1337(a)(1)(H) in all lease sales of deep water leases conducted between November 28, 1995, and November 28, 2000. Section 1337(a)(1)(H) provides for a bidding system of a cash bonus payment and royalty, "and with suspension of royalties for a period, volume, or value of production determined by the Secretary, *which suspension may vary based on the price of production from the lease. . . .*" (Emphasis added.)

The price threshold terms of the leases were not at issue and were not involved in the *Santa Fe Snyder* case. *Santa Fe Snyder* involved a challenge to implementing regulations regarding section 304 leases assigned to a field producing before the DWRRA's enactment and fields with more than one section 304 lease. With regard to those issues, the court said that section 304 imposed an "unambiguous" requirement that all leases issued under that section were entitled to the royalty relief volumes specified in that section without regard to whether the field of which the lease was a part was producing before the DWRRA was enacted, and that the royalty suspension volumes specified in that section

must be applied to each individual lease and not on a "field" basis. 385 F.3d at 891-892. The Fifth Circuit further explained:

> Section 304 requires the Interior [*sic*] to use the bidding system in Section 303 [43 U.S.C. § 1337(a)(1)(H)] which includes discretionary royalty suspension "for a period, volume, or value of production determined by the Secretary." That section, however, immediately excepts and replaces Interior's discretion with a fixed royalty suspension for New Leases on a volume basis by providing, "except that the suspension of royalties shall be set at a volume of not less than the following" (followed by amounts which vary based on water depth).

385 F.3d at 892. There was no mention of the price threshold provision of section 1337(a)(1)(H) or of the price threshold terms of the leases. In fact, the price thresholds are not included in the regulations at issue in *Santa Fe Snyder*. These lease provisions, included pursuant to the Secretary's specific authority in section 1337(a)(1)(H), remain in full force and effect. Kerr-McGee therefore may not avoid enforcement of the price threshold lease provisions on the basis of *Santa Fe Snyder*.

Application of Price Thresholds

In applying the price thresholds, it is necessary to know when production began. Production from the respective Kerr-McGee Leases began in the month indicated below:

Lease Number	Beginning Production Month
0540222950	May 2003
0540222960	May 2002
0540190840	February 2004
0540190280	October 2004
0540174060	December 2003
0540174070	December 2003
0540174080	December 2003
0540173070	November 2002

Therefore, 2002 is the earliest year for which price thresholds are relevant for any of the Kerr-McGee Leases.

Using the formula in the lease terms discussed above, the price thresholds for gas for each Calendar Year (CY) from 2002 through 2004 are:

2002	2003	2004
$4.03	$4.11	$4.19

For CYs 2002 through 2004, MMS/OMM calculated the arithmetic average of the NYMEX closing prices for gas from data published on the Oilnergy.com website. Each day this source reports the closing price for the nearest delivery month (*e.g.*, for most of March the price is for deliveries in April, before changing to May deliveries for about the last 5 trading days in March), as well as an average of these values over the previous 2 months. Monthly averages are calculated based on all days in the month, repeating the value from the last previous trading day for non-trading days, such as weekends and holidays. OMM collects these monthly figures for gas and averages each series over the 12 months in the calendar

year to calculate the average of the gas closing prices on the NYMEX for the year. This information is posted on MMS' website http://www.mms.gov/econ/DWRRA Price1.htm.

The arithmetic averages of the NYMEX gas closing prices for CYs 2002 through 2004 are:

2002	2003	2004
$3.36	$5.49	$6.18

It is readily apparent from this information that the gas price threshold for the Kerr-McGee Leases was exceeded in CYs 2003 and 2004, but not in CY 2002. Therefore, Kerr-McGee owes royalties on gas produced from the identified leases during CYs 2003 and 2004.

Further, using the formula in the lease terms, the oil price thresholds for each CY from 2002 through 2004 are as follows:

2002	2003	2004
$32.27	$32.86	$33.55

The arithmetic average of the NYMEX oil closing prices is calculated in the same manner as the arithmetic average of the NYMEX gas closing prices explained above.

The arithmetic averages of the NYMEX oil closing prices for CYs 2002 through 2004 are:

2002	2003	2004
$26.10	$31.08	$41.38

This information shows that the oil price threshold for the Kerr-McGee Leases was exceeded in CY 2004. Kerr-McGee therefore owes royalties on oil produced from the Kerr-McGee Leases during CY 2004.

Late Payment Interest

Section 111(a) of the Federal Oil and Gas Royalty Management Act of 1982 ("FOGRMA"), 30 U.S.C. § 1721(a), provides:

> In the case of oil and gas leases where royalty payments are not received by the Secretary on the date that such payments are due, or are less than the amount due, the Secretary shall charge interest on such late payments or underpayments at the rate applicable under section 6621 of Title 26. In the case of an underpayment or partial payment, interest shall be computed and charged only on the amount of the deficiency and not on the total amount due.

Subsection (f) of section 1721 further provides:

> Interest shall be charged under this section only for the number of days a payment is late.

Implementing MMS regulations at 30 C.F.R. § 218.54 provide, in relevant part:

> (a) An interest charge shall be assessed on unpaid and underpaid amounts from the date the amounts are due.
>
> (b) The interest charge on late payments shall be at the underpayment rate established by the Internal Revenue Code, 26 U.S.C. 6621(a)(2) (Supp. 1987).

> (c) Interest will be charged only on the amount of the payment not received. Interest will be charged only for the number of days the payment is late.
>
> * * *

In the ordinary situation, royalty is due at the end of the month following the month of production. (*See* 30 C.F.R. § 218.50(a) (2005) and relevant lease terms.) Therefore, in the usual case, late payment interest accrues on unpaid amounts after that date. Under DWRRA section 304 leases, however, royalties were not paid on the usual monthly basis because of the royalty suspension provisions. Kerr-McGee now owed royalties because the price thresholds were exceeded.

The question then becomes when a royalty payment is "late" under these circumstances. The statutory provisions (DWRRA section 304 and 43 U.S.C. § 1337(a)(1)(H) and the lease terms are silent on the specific question of when royalty is due if the price thresholds are exceeded. (There are no MMS regulations that address the price thresholds for section 304 leases.) The royalty suspension provisions apply unless and until the average of the NYMEX closing prices has exceeded the price threshold *for the year*. That calculation cannot be made until after the calendar year ends. The lessee does not owe royalty under the price thresholds until after the year closes. A payment therefore cannot be "late" until sometime after the calendar year ends. Under section 304 leases, the fact that royalty becomes due as a result of the price threshold having been exceeded does not make the due date of a royalty payment retroactive to the end of the month following the month of production.

Once the objective fact that the average of the NYMEX closing prices for the calendar year has exceeded the price threshold occurs, royalty is owed on production during that year as a matter of law under the lease terms. Royalty necessarily becomes due, and late payment interest begins to accrue, no later than a reasonable time after the end of the calendar year, because lessees must be able to calculate the average NYMEX closing prices.

In determining what constitutes a reasonable time, we note that the MMS regulations applicable to the price thresholds for discretionary royalty relief for pre-November 1995 leases and post-November 2000 leases (*i.e.*, leases to which DWRRA section 304 does not apply) prescribe such a time. Specifically, these paragraphs require payment of royalty in the event price thresholds are exceeded by March 31 of the year after the year in which that contingency occurs. 30 C.F.R. § 203.78(a)(1) and (b)(1).[2]

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[2] Title 30 C.F.R. § 203.78(a)(1) and (b)(1) also provide that lessees who owe royalty as a result of price thresholds having been exceeded must pay interest beginning with the month after the month of production. On the surface, that appears to be opposed to the principle stated above, *i.e.*, the fact that royalty becomes due as a result of the price threshold having been exceeded does not make the due date of a royalty payment retroactive to the end of the month following the month of production. However, section 203.78(a) and (b) reflect a unique statutory provision included in section 302 of the DWRRA, 43 U.S.C. § 1337(a)(3)(C). DWRRA section 302 provides for discretionary royalty relief for leases already in existence in November 1995 if "new production" (as defined in the statute) from such leases would not be economic without royalty relief. Section 1337(a)(3)(C)(v) and (vi) require that if the price thresholds prescribed in those clauses for oil and gas, respectively, are exceeded, "any production of [oil or gas] will be subject to royalties at the lease stipulated royalty rate." These clauses

If three months after the close of the calendar year is a reasonable period in which to calculate the average NYMEX closing prices and to calculate and report any royalties due in the context of price thresholds for discretionary royalty relief for leases not subject to DWRRA section 304, it would also be a reasonable time to perform the same functions under section 304 leases.[3]

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then further provide that "[e]stimated royalty payments will be made if such average of the closing prices for the previous year exceeds $28.00. After the end of the calendar year, when the new average price can be calculated, lessees will pay any royalty due, with interest but without penalty, or can apply for a refund, with interest, of any overpayment." Section 203.78(a) and (b) in the regulations implement this requirement (and also extend it by rule to post-November 2000 leases under the general royalty relief authority granted in 43 U.S.C. § 1337(a)(3)(B)). DWRRA section 304 contains no analogous provisions requiring estimated payments if the price thresholds were exceeded in the preceding year with a subsequent "true up" after the end of the calendar year. Thus, similar interest requirements beginning with the month after the month of production would not apply to the Kerr-McGee Leases.

[3] It may be argued that because royalty is due at the end of the month following the month of production unless royalty suspension provisions apply, royalty becomes due immediately once the suspension provisions no longer apply as a result of the price threshold contingency having occurred. Under such a view, royalty would be due at the end of the first month of production following the year in which the price thresholds were exceeded (*i.e.*, the end of January of the following year, which also would be the due date for royalties owed on production in December). Nor would it appear unreasonable to expect that lessees could calculate average NYMEX closing prices and calculate royalties due for the year within a month after the year closes. Under that approach, late payment interest would begin to accrue after January 31. However, the regulations discussed above applicable to royalty relief for leases not subject to section 304 did not take that position, and this decision is consistent with the approach taken in those rules—a result favorable to the lessee.

Therefore, Kerr-McGee must calculate and pay late payment interest beginning on April 1 of the year after the year in which a price threshold was exceeded.

Ownership Interest in the Kerr-McGee Leases

Section 6(g) of the Federal Oil and Gas Royalty Simplification and Fairness Act of 1996, Pub. L. No. 104-185, 110 Stat. 1700, 1715, amended FOGRMA section 102(a), 30 U.S.C. § 1712(a), to provide in relevant part:

> . . . A lessee may designate a person to make all or part of the payments due under a lease on the lessee's behalf and shall notify the Secretary or the applicable delegated State in writing of such designation, in which event said designated person may, in its own name, pay, offset or credit monies, make adjustments, request and receive refunds and submit reports with respect to payments required by the lessee. Notwithstanding any other provision of this Act to the contrary, a designee shall not be liable for any payment obligation under the lease. *The person owning operating rights in a lease shall be primarily liable for its pro rata share of payment obligations under the lease.* If the person owning the legal record title in a lease is other than the operating rights owner, the person owning the legal record title shall be secondarily liable for its pro rata share of such payment obligations under the lease. (Emphasis added.)

The MMS records indicate that during the relevant periods covered by this decision, Kerr-McGee owned (and presently owns):

- 50 percent of the working interest in Lease nos. 0540174060, 0540174070, 0540174080, 0540222950, and 0540222960. Other co-lessees own the other 50 percent of the working interest. According to MMS records, operating rights have not been severed from the record title interest.

- 66.67 percent of the operating rights (and essentially the same proportion (66.66663 percent) of the record title interest) in Lease no. 0540190840. Other interest holders own the remaining 33.33 percent of both the operating rights and the record title interest.

- 33.3333 percent of the working interest in Lease no. 0540190280. Other interest holders own the remaining 66.6667 percent of the working interest. According to MMS records, operating rights have not been severed from the record title interest.

- 25 percent of the operating rights from the surface of the earth down through 15,000 feet and 16.6667 percent of the operating rights from 15,000 feet through 50,000 feet (but none of the record title interest) in Lease no. 0540173070. Other interest holders own the remaining 75 percent and 83.33 percent, respectively, of the operating rights in the identified depth zones. Yet another interest holder owns 100 percent of the record title interest.

Requirement to Calculate and Pay Royalties and Interest

Gas

For the reasons explained above, Kerr-McGee is hereby ordered to calculate, report, and pay royalties on the percentage of all volumes of gas removed or sold from each of the Kerr-McGee Leases during CYs 2003 and 2004 that corresponds to its respective working interest or operating rights ownership percentage in each lease.[4]

Kerr-McGee is also ordered to calculate, report, and pay late payment interest under 30 U.S.C. § 1721(a) and 30 C.F.R. § 218.54 beginning on:

- April 1, 2004, for royalties due on production in CY 2003 and continuing until payment is made to MMS; and
- April 1, 2005, for royalties due on production in CY 2004 and continuing until payment is made to MMS.

Oil

Kerr-McGee is further ordered to calculate, report, and pay royalties on the percentage of all volumes of oil removed or sold from each of the Kerr-McGee Leases during CY 2004 that corresponds to Kerr-McGee's respective operating rights ownership percentage in each lease, together with late payment interest under 30 U.S.C. § 1721(a) and 30 C.F.R. § 218.54 beginning on April 1, 2005, until payment is made to MMS.

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[4] The requirement to pay royalties does not apply to production that is not royalty bearing in the absence of royalty relief, such as gas that is unavoidably lost or gas used on or for the benefit of the lease.

Kerr-McGee is further ordered to submit its reports and payments within 45 days after receipt of this Order.

How to Report and Pay

Under 30 C.F.R. § 210.20, you must report electronically unless you are exempted under 30 C.F.R. § 210.22. Under 30 C.F.R. § 218.51, you must pay electronically unless it is not cost-effective or practical to do so. When reporting and paying:

- Use procedures outlined in 30 C.F.R. § 210.21 for electronic reporting of Form MMS-2014. Complete reporting instructions are found in chapter 9 of the *Minerals Revenue Reporter Handbook—Oil, Gas, and Geothermal Resources.* This information is also on the MMS website at www.mrm.mms.gov.
- Use procedures outlined in 30 C.F.R. § 218.51(b) for electronic payments and the Automated Clearing House/FEDWIRE instructions on the MMS website at www.mrm.mms.gov/ReportingServices/ElecRepting. Be sure to reference the Form MMS-2014 block 4 number in the electronic payment document. Use adjustment reason code 17 on your Form MMS-2014. Place the number 82029718 in block 4.

If you need assistance in reporting and paying, please call (800) 525-0309.

Consequences of Noncompliance

If you fail to comply with this decision, MMS may assess civil penalties under FOGRMA section 109, 30 U.S.C. § 1719, and implementing regulations at 30 C.F.R. Part 241. The Department of the Interior may also seek judi-

cial enforcement of this decision and pursue any other available remedies.

Final Departmental Decision

Because this decision is issued by an Assistant Secretary of the Department of the Interior, it constitutes the final action of the Department and is not appealable to the Interior Board of Land Appeals. *Blue Star, Inc.*, 41 IBLA 333 (1979); *Marathon Oil Co.*, 102 IBLA 177 (1989).

Sincerely,

/s/ JOHNNIE BURTON
R.M. "Johnnie" Burton
Acting Assistant Secretary
Land and Minerals Management

APPENDIX D

UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 08-30069

KERR-MCGEE OIL AND GAS CORP.,
PLAINTIFF-APPELLEE

v.

UNITED STATES DEPARTMENT OF INTERIOR;
C. STEPHEN ALLRED, ASSISTANT SECRETARY, ON
BEHALF OF LAND & MINERALS MANAGEMENT, ON
BEHALF OF UNITED STATES DEPARTMENT OF
INTERIOR, DEFENDANTS-APPELLANTS

[Filed: Apr. 14, 2009]

Appeal from the United States District Court for the
Western District of Louisiana at Lake Charles

ON PETITION FOR REHEARING EN BANC

(Opinion_____, 5 Cir., _____, _____ F.3d _____)

Before: KING, DENNIS, and ELROD, Circuit Judges.

PER CURIAM:

Treating the Petition for Rehearing En Banc as a Petition for Panel Rehearing, the Petition for Panel Rehearing is DENIED. No member of the panel nor judge in regular active service of the court having requested that the court be polled on Rehearing En Banc (FED. R. APP. P. and 5TH CIR. R. 35), the Petition for Rehearing En Banc is DENIED.

ENTERED FOR THE COURT:

/s/ CAROLYN DINEEN KING
United States Circuit Judge

APPENDIX E

1. 43 U.S.C. 1334 provides in pertinent part:

Administration of leasing

(a) Rules and regulations; amendment; cooperation with State agencies; subject matter and scope of regulations

The Secretary shall administer the provisions of this subchapter relating to the leasing of the outer Continental Shelf, and shall prescribe such rules and regulations as may be necessary to carry out such provisions. The Secretary may at any time prescribe and amend such rules and regulations as he determines to be necessary and proper in order to provide for the prevention of waste and conservation of the natural resources of the outer Continental Shelf, and the protection of correlative rights therein, and, notwithstanding any other provisions herein, such rules and regulations shall, as of their effective date, apply to all operations conducted under a lease issued or maintained under the provisions of this subchapter. In the enforcement of safety, environmental, and conservation laws and regulations, the Secretary shall cooperate with the relevant departments and agencies of the Federal Government and of the affected States. In the formulation and promulgation of regulations, the Secretary shall request and give due consideration to the views of the Attorney General with respect to matters which may affect competition. In considering any regulations and in preparing any such views, the Attorney General shall consult with the Federal Trade Commission. The regulations prescribed by

the Secretary under this subsection shall include, but not be limited to, provisions—

(1) for the suspension or temporary prohibition of any operation or activity, including production, pursuant to any lease or permit (A) at the request of a lessee, in the national interest, to facilitate proper development of a lease or to allow for the construction or negotiation for use of transportation facilities, or (B) if there is a threat of serious, irreparable, or immediate harm or damage to life (including fish and other aquatic life), to property, to any mineral deposits (in areas leased or not leased), or to the marine, coastal, or human environment, and for the extension of any permit or lease affected by suspension or prohibition under clause (A) or (B) by a period equivalent to the period of such suspension or prohibition, except that no permit or lease shall be so extended when such suspension or prohibition is the result of gross negligence or willful violation of such lease or permit, or of regulations issued with respect to such lease or permit;

(2) with respect to cancellation of any lease or permit—

(A) that such cancellation may occur at any time, if the Secretary determines, after a hearing, that—

(i) continued activity pursuant to such lease or permit would probably cause serious harm or damage to life (including fish and other aquatic life), to property, to any mineral (in areas leased or not leased), to the national secu-

rity or defense, or to the marine, coastal, or human environment;

(ii) the threat of harm or damage will not disappear or decrease to an acceptable extent within a reasonable period of time; and

(iii) the advantages of cancellation outweigh the advantages of continuing such lease or permit force;

(B) that such cancellation shall not occur unless and until operations under such lease or permit shall have been under suspension, or temporary prohibition, by the Secretary, with due extension of any lease or permit term continuously for a period of five years, or for a lesser period upon request of the lessee;

(C) that such cancellation shall entitle the lessee to receive such compensation as he shows to the Secretary as being equal to the lesser of (i) the fair value of the canceled rights as of the date of cancellation, taking account of both anticipated revenues from the lease and anticipated costs, including costs of compliance with all applicable regulations and operating orders, liability for cleanup costs or damages, or both, in the case of an oilspill, and all other costs reasonably anticipated on the lease, or (ii) the excess, if any, over the lessee's revenues, from the lease (plus interest thereon from the date of receipt to date of reimbursement) of all consideration paid for the lease and all direct expenditures made by the lessee after the date of issuance of such lease and in connection with exploration or development, or

both, pursuant to the lease (plus interest on such consideration and such expenditures from date of payment to date of reimbursement), except that (I) with respect to leases issued before September 18, 1978, such compensation shall be equal to the amount specified in clause (i) of this subparagraph; and (II) in the case of joint leases which are canceled due to the failure of one or more partners to exercise due diligence, the innocent parties shall have the right to seek damages for such loss from the responsible party or parties and the right to acquire the interests of the negligent party or parties and be issued the lease in question;

(3) for the assignment or relinquishment of a lease;

(4) for unitization, pooling, and drilling agreements;

(5) for the subsurface storage of oil and gas from any source other than by the Federal Government;

(6) for drilling or easements necessary for exploration, development, and production;

(7) for the prompt and efficient exploration and development of a lease area; and

(8) for compliance with the national ambient air quality standards pursuant to the Clean Air Act (42 U.S.C. 7401 et seq.), to the extent that activities authorized under this subchapter significantly affect the air quality of any State.

* * * * *

2. 43 U.S.C. 1337 provides in pertinent part:

Leases, easements, and rights-of-way on the outer Continental Shelf

(a) Oil and gas leases; award to highest responsible qualified bidder; method of bidding; royalty relief; Congressional consideration of bidding system; notice

(1) The Secretary is authorized to grant to the highest responsible qualified bidder or bidders by competitive bidding, under regulations promulgated in advance, any oil and gas lease on submerged lands of the outer Continental Shelf which are not covered by leases meeting the requirements of subsection (a) of section 1335 of this title. Such regulations may provide for the deposit of cash bids in an interest-bearing account until the Secretary announces his decision on whether to accept the bids, with the interest earned thereon to be paid to the Treasury as to bids that are accepted and to the unsuccessful bidders as to bids that are rejected. The bidding shall be by sealed bid and, at the discretion of the Secretary, on the basis of—

(A) cash bonus bid with a royalty at not less than 12½ per centum fixed by the Secretary in amount or value of the production saved, removed, or sold;

(B) variable royalty bid based on a per centum in amount or value of the production saved, removed, or sold, with either a fixed work commitment based on dollar amount for exploration or a fixed cash bonus as determined by the Secretary, or both;

(C) cash bonus bid, or work commitment bid based on a dollar amount for exploration with a fixed cash bonus, and a diminishing or sliding royalty

based on such formulae as the Secretary shall determine as equitable to encourage continued production from the lease area as resources diminish, but not less than 12½ per centum at the beginning of the lease period in amount or value of the production saved, removed, or sold;

(D) cash bonus bid with a fixed share of the net profits of no less than 30 per centum to be derived from the production of oil and gas from the lease area;

(E) fixed cash bonus with the net profit share reserved as the bid variable;

(F) cash bonus bid with a royalty at no less than 12½ per centum fixed by the Secretary in amount or value of the production saved, removed, or sold and a fixed per centum share of net profits of no less than 30 per centum to be derived from the production of oil and gas from the lease area;

(G) work commitment bid based on a dollar amount for exploration with a fixed cash bonus and a fixed royalty in amount or value of the production saved, removed, or sold;

(H) cash bonus bid with royalty at no less than 12 and ½ per centum fixed by the Secretary in amount or value of production saved, removed, or sold, and with suspension of royalties for a period, volume, or value of production determined by the Secretary, which suspensions may vary based on the price of production from the lease; or

(I) subject to the requirements of paragraph (4) of this subsection, any modification of bidding sys-

tems authorized in suparagraphs (A) through (G), or any other systems of bid variables, terms, and conditions which the Secretary determines to be useful to accomplish the purposes and policies of this subchapter, except that no such bidding system or modification shall have more than one bid variable.

(2) The Secretary may, in his discretion, defer any part of the payment of the cash bonus, as authorized in paragraph (1) of this subsection, according to a schedule announced at the time of the announcement of the lease sale, but such payment shall be made in total no later than five years after the date of the lease sale.

(3)(A) The Secretary may, in order to promote increased production on the lease area, through direct, secondary, or tertiary recovery means, reduce or eliminate any royalty or net profit share set forth in the lease for such area.

(B) In the Western and Central Planning Areas of the Gulf of Mexico and the portion of the Eastern Planning Area of the Gulf of Mexico encompassing whole lease blocks lying west of 87 degrees, 30 minutes West longitude and in the Planning Areas offshore Alaska, the Secretary may, in order to—

(i) promote development or increased production on producing or non-producing leases; or

(ii) encourage production of marginal resources on producing or non-producing leases;

through primary, secondary, or tertiary recovery means, reduce or eliminate any royalty or net profit share set forth in the lease(s). With the lessee's consent, the Secretary may make other modifications to the royalty or

net profit share terms of the lease in order to achieve these purposes.

(C)(i) Notwithstanding the provisions of this subchapter other than this subparagraph, with respect to any lease or unit in existence on November 28, 1995, meeting the requirements of this subparagraph, no royalty payments shall be due on new production, as defined in clause (iv) of this subparagraph, from any lease or unit located in water depths of 200 meters or greater in the Western and Central Planning Areas of the Gulf of Mexico, including that portion of the Eastern Planning Area of the Gulf of Mexico encompassing whole lease blocks lying west of 87 degrees, 30 minutes West longitude, until such volume of production as determined pursuant to clause (ii) has been produced by the lessee.

(ii) Upon submission of a complete application by the lessee, the Secretary shall determine within 180 days of such application whether new production from such lease or unit would be economic in the absence of the relief from the requirement to pay royalties provided for by clause (i) of this subparagraph. In making such determination, the Secretary shall consider the increased technological and financial risk of deep water development and all costs associated with exploring, developing, and producing from the lease. The lessee shall provide information required for a complete application to the Secretary prior to such determination. The Secretary shall clearly define the information required for a complete application under this section. Such application may be made on the basis of an individual lease or unit. If the Secretary determines that such new production would be economic in the absence of the relief from the requirement to pay royalties provided for by

clause (i) of this subparagraph, the provisions of clause (i) shall not apply to such production. If the Secretary determines that such new production would not be economic in the absence of the relief from the requirement to pay royalties provided for by clause (i), the Secretary must determine the volume of production from the lease or unit on which no royalties would be due in order to make such new production economically viable; except that for new production as defined in clause (iv)(I), in no case will that volume be less than 17.5 million barrels of oil equivalent in water depths of 200 to 400 meters, 52.5 million barrels of oil equivalent in 400-800 meters of water, and 87.5 million barrels of oil equivalent in water depths greater than 800 meters. Redetermination of the applicability of clause (i) shall be undertaken by the Secretary when requested by the lessee prior to the commencement of the new production and upon significant change in the factors upon which the original determination was made. The Secretary shall make such redetermination within 120 days of submission of a complete application. The Secretary may extend the time period for making any determination or redetermination under this clause for 30 days, or longer if agreed to by the applicant, if circumstances so warrant. The lessee shall be notified in writing of any determination or redetermination and the reasons for and assumptions used for such determination. Any determination or redetermination under this clause shall be a final agency action. The Secretary's determination or redetermination shall be judicially reviewable under section 702 of title 5, only for actions filed within 30 days of the Secretary's determination or redetermination.

(iii) In the event that the Secretary fails to make the determination or redetermination called for in clause (ii)

upon application by the lessee within the time period, together with any extension thereof, provided for by clause (ii), no royalty payments shall be due on new production as follows:

(I) For new production, as defined in clause (iv)(I) of this subparagraph, no royalty shall be due on such production according to the schedule of minimum volumes specified in clause (ii) of this subparagraph.

(II) For new production, as defined in clause (iv)(II) of this subparagraph, no royalty shall be due on such production for one year following the start of such production.

(iv) For purposes of this subparagraph, the term "new production" is—

(I) any production from a lease from which no royalties are due on production, other than test production, prior to November 28, 1995; or

(II) any production resulting from lease development activities pursuant to a Development Operations Coordination Document, or supplement thereto that would expand production significantly beyond the level anticipated in the Development Operations Coordination Document, approved by the Secretary after November 28, 1995.

(v) During the production of volumes determined pursuant to clauses[1] (ii) or (iii) of this subparagraph, in any year during which the arithmetic average of the

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[1] So in original. Probably should be "clause".

closing prices on the New York Mercantile Exchange for light sweet crude oil exceeds $28.00 per barrel, any production of oil will be subject to royalties at the lease stipulated royalty rate. Any production subject to this clause shall be counted toward the production volume determined pursuant to clause (ii) or (iii). Estimated royalty payments will be made if such average of the closing prices for the previous year exceeds $28.00. After the end of the calendar year, when the new average price can be calculated, lessees will pay any royalties due, with interest but without penalty, or can apply for a refund, with interest, of any overpayment.

(vi) During the production of volumes determined pursuant to clause (ii) or (iii) of this subparagraph, in any year during which the arithmetic average of the closing prices on the New York Mercantile Exchange for natural gas exceeds $3.50 per million British thermal units, any production of natural gas will be subject to royalties at the lease stipulated royalty rate. Any production subject to this clause shall be counted toward the production volume determined pursuant to clauses[1] (ii) or (iii). Estimated royalty payments will be made if such average of the closing prices for the previous year exceeds $3.50. After the end of the calendar year, when the new average price can be calculated, lessees will pay any royalties due, with interest but without penalty, or can apply for a refund, with interest, of any overpayment.

(vii) The prices referred to in clauses (v) and (vi) of this subparagraph shall be changed during any calendar year after 1994 by the percentage, if any, by which the

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[1] So in original. Probably should be "clause".

implicit price deflator for the gross domestic product changed during the preceding calendar year.

(4)(A) The Secretary of Energy shall submit any bidding system authorized in subparagraph (H) of paragraph (1) to the Senate and House of Representatives. The Secretary may institute such bidding system unless either the Senate or the House of Representatives passes a resolution of disapproval within thirty days after receipt of the bidding system.

(B) Subparagraphs (C) through (J) of this paragraph are enacted by Congress—

(i) as an exercise of the rulemaking power of the Senate and the House of Representatives, respectively, and as such they are deemed a part of the rules of each House, respectively, but they are applicable only with respect to the procedures to be followed in that House in the case of resolutions described by this paragraph, and they supersede other rules only to the extent that they are inconsistent therewith; and

(ii) with full recognition of the constitutional right of either House to change the rules (so far as relating to the procedure of that House) at any time, in the same manner, and to the same extent as in the case of any other rule of that House.

(C) A resolution disapproving a bidding system submitted pursuant to this paragraph shall immediately be referred to a committee (and all resolutions with respect to the same request shall be referred to the same committee) by the President of the Senate or the Speaker of the House of Representatives, as the case may be.

(D) If the committee to which has been referred any resolution disapproving the bidding system of the Secretary has not reported the resolution at the end of ten calendar days after its referral, it shall be in order to move either to discharge the committee from further consideration of the resolution or to discharge the committee from further consideration of any other resolution with respect to the same bidding system which has been referred to the committee.

(E) A motion to discharge may be made only by an individual favoring the resolution, shall be highly privileged (except that it may not be made after the committee has reported a resolution with respect to the same recommendation), and debate thereon shall be limited to not more than one hour, to be divided equally between those favoring and those opposing the resolution. An amendment to the motion shall not be in order, and it shall not be in order to move to reconsider the vote by which the motion is agreed to or disagreed to.

(F) If the motion to discharge is agreed to or disagreed to, the motion may not be renewed, nor may another motion to discharge the committee be made with respect to any other resolution with respect to the same bidding system.

(G) When the committee has reported, or has been discharged from further consideration of, a resolution as provided in this paragraph, it shall be at any time thereafter in order (even though a previous motion to the same effect has been disagreed to) to move to proceed to the consideration of the resolution. The motion shall be highly privileged and shall not be debatable. An amendment to the motion shall not be in order, and it shall not

be in order to move to reconsider the vote by which the motion is agreed to or disagreed to.

(H) Debate on the resolution is limited to not more than two hours, to be divided equally between those favoring and those opposing the resolution. A motion further to limit debate is not debatable. An amendment to, or motion to recommit, the resolution is not in order, and it is not in order to move to reconsider the vote by which the resolution is agreed to or disagreed to.

(I) Motions to postpone, made with respect to the discharge from the committee, or the consideration of a resolution with respect to a bidding system, and motions to proceed to the consideration of other business, shall be decided without debate.

(J) Appeals from the decisions of the Chair relating to the application of the rules of the Senate or the House of Representatives, as the case may be, to the procedure relating to a resolution with respect to a bidding system shall be decided without debate.

(5)(A) During the five-year period commencing on September 18, 1978, the Secretary may, in order to obtain statistical information to determine which bidding alternatives will best accomplish the purposes and policies of this subchapter, require, as to no more than 10 per centum of the tracts offered each year, each bidder to submit bids for any area of the outer Continental Shelf in accordance with more than one of the bidding systems set forth in paragraph (1) of this subsection. For such statistical purposes, leases may be awarded using a bidding alternative selected at random for the acquisition of valid statistical data if such bidding alternative is otherwise consistent with the provisions of this subchapter.

(B) The bidding systems authorized by paragraph (1) of this subsection, other than the system authorized by subparagraph (A), shall be applied to not less than 20 per centum and not more than 60 per centum of the total area offered for leasing each year during the five-year period beginning on September 18, 1978, unless the Secretary determines that the requirements set forth in this subparagraph are inconsistent with the purposes and policies of this subchapter.

(6) At least ninety days prior to notice of any lease sale under subparagraph (D), (E), (F), or, if appropriate, (H) of paragraph (1), the Secretary shall by regulation establish rules to govern the calculation of net profits. In the event of any dispute between the United States and a lessee concerning the calculation of the net profits under the regulation issued pursuant to this paragraph, the burden of proof shall be on the lessee.

(7) After an oil and gas lease is granted pursuant to any of the work commitment options of paragraph (1) of this subsection—

(A) the lessee, at its option, shall deliver to the Secretary upon issuance of the lease either (i) a cash deposit for the full amount of the exploration work commitment, or (ii) a performance bond in form and substance and with a surety satisfactory to the Secretary, in the principal amount of such exploration work commitment assuring the Secretary that such commitment shall be faithfully discharged in accordance with this section, regulations, and the lease; and for purposes of this subparagraph, the principal amount of such cash deposit or bond may, in accordance with regulations, be periodically reduced upon

proof, satisfactory to the Secretary, that a portion of the exploration work commitment has been satisfied;

(B) 50 per centum of all exploration expenditures on, or directly related to, the lease, including, but not limited to (i) geological investigations and related activities, (ii) geophysical investigations including seismic, geomagnetic, and gravity surveys, data processing and interpretation, and (iii) exploratory drilling, core drilling, redrilling, and well completion or abandonment, including the drilling of wells sufficient to determine the size and a real extent of any newly discovered field, and including the cost of mobilization and demobilization of drilling equipment, shall be included in satisfaction of the commitment, except that the lessee's general overhead cost shall not be so included against the work commitment, but its cost (including employee benefits) of employees directly assigned to such exploration work shall be so included; and

(C) if at the end of the primary term of the lease, including any extension thereof, the full dollar amount of the exploration work commitment has not been satisfied, the balance shall then be paid in cash to the Secretary.

(8) Not later than thirty days before any lease sale, the Secretary shall submit to the Congress and publish in the Federal Register a notice—

(A) identifying any bidding system which will be utilized for such lease sale and the reasons for the utilization of such bidding system; and

(B) designating the lease tracts selected which are to be offered in such sale under the bidding sys-

tem authorized by subparagraph (A) of paragraph (1) and the lease tracts selected which are to be offered under any one or more of the bidding systems authorized by subparagraphs (B) through (H) of paragraph (1), and the reasons such lease tracts are to be offered under a particular bidding system.

(b) Terms and provisions of oil and gas leases

An oil and gas lease issued pursuant to this section shall—

(1) be for a tract consisting of a compact area not exceeding five thousand seven hundred and sixty acres, as the Secretary may determine, unless the Secretary finds that a larger area is necessary to comprise a reasonable economic production unit;

(2) be for an initial period of—

(A) five years; or

(B) not to exceed ten years where the Secretary finds that such longer period is necessary to encourage exploration and development in areas because of unusually deep water or other unusually adverse conditions,

and as long after such initial period as oil or gas is produced from the area in paying quantities, or drilling or well reworking operations as approved by the Secretary are conducted thereon;

(3) require the payment of amount or value as determined by one of the bidding systems set forth in subsection (a) of this section;

(4) entitle the lessee to explore, develop, and produce the oil and gas contained within the lease area, conditioned upon due diligence requirements and the approval of the development and production plan required by this subchapter;

(5) provide for suspension or cancellation of the lease during the initial lease term or thereafter pursuant to section 1334 of this title;

(6) contain such rental and other provisions as the Secretary may prescribe at the time of offering the area for lease; and

(7) provide a requirement that the lessee offer 20 per centum of the crude oil, condensate, and natural gas liquids produced on such lease, at the market value and point of delivery applicable to Federal royalty oil, to small or independent refiners as defined in the Emergency Petroleum Allocation Act of 1973 [15 U.S.C. 751 *et seq.*].

* * * * *

3. 43 U.S.C. 1344 provides in pertinent part:

Outer Continental Shelf leasing program

(a) Schedule of proposed oil and gas lease sales

The Secretary, pursuant to procedures set forth in subsections (c) and (d) of this section, shall prepare and periodically revise, and maintain an oil and gas leasing program to implement the policies of this subchapter. The leasing program shall consist of a schedule of proposed lease sales indicating, as precisely as possible, the size, timing, and location of leasing activity which he

determines will best meet national energy needs for the five-year period following its approval or reapproval. Such leasing program shall be prepared and maintained in a manner consistent with the following principles:

(1) Management of the outer Continental Shelf shall be conducted in a manner which considers economic, social, and environmental values of the renewable and nonrenewable resources contained in the outer Continental Shelf, and the potential impact of oil and gas exploration on other resource values of the outer Continental Shelf and the marine, coastal, and human environments.

(2) Timing and location of exploration, development, and production of oil and gas among the oil- and gas-bearing physiographic regions of the outer Continental Shelf shall be based on a consideration of—

(A) existing information concerning the geographical, geological, and ecological characteristics of such regions;

(B) an equitable sharing of developmental benefits and environmental risks among the various regions;

(C) the location of such regions with respect to, and the relative needs of, regional and national energy markets;

(D) the location of such regions with respect to other uses of the sea and seabed, including fisheries, navigation, existing or proposed sealanes, potential sites of deepwater ports, and other an-

ticipated uses of the resources and space of the outer Continental Shelf;

(E) the interest of potential oil and gas producers in the development of oil and gas resources as indicated by exploration or nomination;

(F) laws, goals, and policies of affected States which have been specifically identified by the Governors of such States as relevant matters for the Secretary's consideration;

(G) the relative environmental sensitivity and marine productivity of different areas of the outer Continental Shelf; and

(H) relevant environmental and predictive information for different areas of the outer Continental Shelf.

(3) The Secretary shall select the timing and location of leasing, to the maximum extent practicable, so as to obtain a proper balance between the potential for environmental damage, the potential for the discovery of oil and gas, and the potential for adverse impact on the coastal zone.

(4) Leasing activities shall be conducted to assure receipt of fair market value for the lands leased and the rights conveyed by the Federal Government.

* * * * *

4. Outer Continental Shelf Deep Water Royalty Relief Act, Pub. L. No. 104-58, §§ 304 and 305, 109 Stat. 565-566 (1995), provide:

SEC. 304. LEASE SALES.

For all tracts located in water depths of 200 meters or greater in the Western and Central Planning Area of the Gulf of Mexico, including that portion of the Eastern Planning Area of the Gulf of Mexico encompassing whole lease blocks lying west of 87 degrees, 30 minutes West longitude, any lease sale within five years of the date of enactment of this title, shall use the bidding system authorized in section 8(a)(1)(H) of the Outer Continental Shelf Lands Act, as amended by this title, except that the suspension of royalties shall be set at a volume of not less than the following:

(1) 17.5 million barrels of oil equivalent for leases in water depths of 200 to 400 meters;

(2) 52.5 million barrels of oil equivalent for leases in 400 to 800 meters of water; and

(3) 87.5 million barrels of oil equivalent for leases in water depths greater than 800 meters.

SEC. 305. REGULATIONS.

The Secretary shall promulgate such rules and regulations as are necessary to implement the provisions of this title within 180 days after the enactment of this Act.